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# The Economist

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A fake election in Russia

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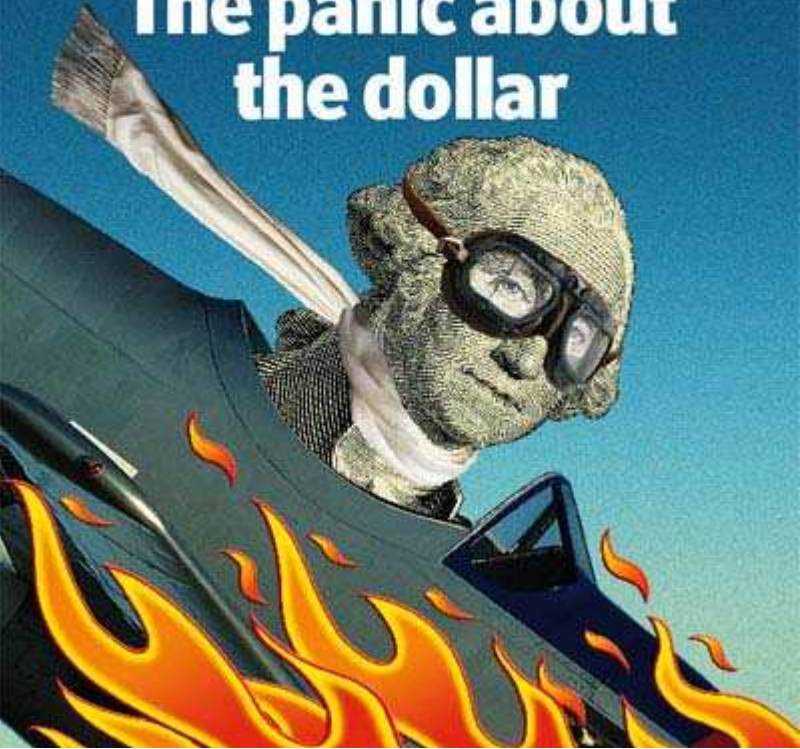
# The panic about the dollar



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# Politics this week

Nov 29th 2007
From The Economist print edition

EPA

George Bush hosted a **Middle East peace summit** in Annapolis, Maryland. As well as the Israeli and Palestinian delegations, Saudi Arabia, Syria and other Arab states also came. The conference ended with a commitment to the goal of a Palestinian state, and a promise of immediate talks, but with no mention of borders, Jerusalem or Jewish settlements on the West Bank. Hamas, the rejectionist Islamist group that controls the Gaza Strip, held a huge rally and denounced Mahmoud Abbas, the Palestinian president. See article

**Zimbabwe's** chief statistician said that he can no longer work out the country's inflation rate because there are not enough goods left in the shops to count. In September inflation was reckoned to be almost 8,000%.

The United Nations said that the Sudanese government was obstructing the deployment of a 26,000-strong peacekeeping force in **Darfur**, which could “make it impossible for the mission to operate”. Sticking-points include the Sudanese refusal to allow night flights and the participation of non-African troops.

A British teacher, Gillian Gibbons, was charged with blasphemy in **Sudan** after allowing her class to name a teddy bear Muhammad.

## Ruddy good show

After 11 years as **Australia's** prime minister, John Howard lost an election to Kevin Rudd's Labor Party. Mr Rudd marked his victory by accepting an invitation to this month's climate-change meeting in Bali, and by promising to make a formal apology to Australia's indigenous people for past mistreatment. See article

Having legitimised his “re-election” as **Pakistan's** president through a handpicked Supreme Court, Pervez Musharraf shed a tear as he relinquished command of the army. The next day he was sworn in as a “civilian” president. Nawaz Sharif, the prime minister ousted by Mr Musharraf in a coup in 1999, returned home and filed his nomination for a parliamentary election due on January 8th, even though he still wants other opposition parties to join a boycott of the ballot. See article

AP

Senior European Union officials flew to Beijing for their annual summit with **China**. It was marked by sharper-than-usual European criticism of China's mounting trade surplus and weak currency. Nicolas Sarkozy, president of France, preceded the EU in Beijing and oversaw the signing of French contracts worth billions of euros. See article

At least 16 people were killed in a bomb explosion in **Sri Lanka's** capital, Colombo. A day earlier the Liberation Tigers of Tamil Eelam described as “naive” the hope for peace in its 24-year war with the government.

Rebel soldiers in the **Philippines**, many facing trial for a mutiny in 2003, briefly occupied a hotel in Manila. They surrendered when the army stormed the building.

In **Japan**, a former defence-ministry high-flyer, Takemasa Moriya, was arrested along with his wife in a growing defence-procurement scandal that is proving an embarrassment for the already fragile government of Yasuo Fukuda.

## Troubled streets

Two years after a previous round of riots in **Paris's** *banlieues*, a fresh set of disturbances broke out following the deaths of two youths in a motorbike accident involving a police car. As well as the usual car burnings, some rioters used shotguns. President Nicolas Sarkozy promised a tough response. See article

**Russia's** president, Vladimir Putin, accused America of stopping international observers from coming to monitor the Russian parliamentary election on December 2nd. The United Russia party that he now heads is expected to win by a landslide. See article

The **Croatian election** saw the ruling HDZ party take the biggest number of seats, but it may have to depend on a small Eurosceptic party for a parliamentary majority. The opposition Social Democrats refuse to concede defeat.

A final round of internationally supervised talks between Kosovo Albanians and Serbs failed to reach agreement on **Kosovo's** future status. The Kosovo Albanians say they may declare independence from Serbia unilaterally soon after the UN deadline of December 10th. See article

## Diplomatic words

**Venezuela** recalled its ambassador to **Colombia** amid rising tensions between the two countries. The dispute began soon after President Álvaro Uribe of Colombia ended the involvement of his Venezuelan counterpart, Hugo Chávez, in hostage negotiations with the FARC rebel group. The Venezuelan president called the decision a “spit in the face”. See article

Seven football fans in **Brazil** fell to their deaths after part of a stadium in Salvador collapsed. The city is a candidate to stage matches in the 2014 World Cup, awarded in October to Brazil.

Police in **Peru** said they had killed Epifanio Espiritu Acosta, second-in-command of one of the two remaining Maoist Shining Path groups, now increasingly involved in drug-trafficking.

The Simon Wiesenthal Centre extended its final effort to track down and prosecute former Nazi war criminals to **Latin America**. Chile, Uruguay, Argentina and Brazil will now take part in the campaign, which includes rewards for information leading to a conviction.

## Perfect timing

There was another departure from the **White House**. Allan Hubbard stepped down as head of the National Economic Council, joining a lengthy list of senior officials who have left the administration this year. He goes amid talk of a possible recession.

**Trent Lott**, who has been politically rehabilitated since resigning as Republican Senate leader in 2002 because of some ill-considered remarks on race, took colleagues by surprise by saying he would retire from Congress.

The Republicans held their **YouTube debate**, with the public submitting their questions via video. Although the clips were less amusing than those in the Democrats' YouTube forum, the candidates made up for the entertainment deficit by slugging it out over immigration and other issues. Meanwhile, the Democrats cancelled a forthcoming television debate because they do not want to cross a writers' picket at the studio.

AP

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# Business this week

Nov 29th 2007
From The Economist print edition

**Citigroup** announced that it had raised $7.5 billion in capital by selling a 4.9% stake to the investment arm of the emirate of **Abu Dhabi.** Citi has been afflicted by a series of woes, including billions of dollars in write-downs stemming from subprime mortgages, but is also under pressure from shareholders to increase the value of its stock. Separately, in a busy week for sovereign wealth funds based in the Gulf states, a fund manager owned by the ruler of **Dubai** made a "substantial investment" in **Sony**. See article

It emerged that HSBC is transferring onto its balance-sheet $45 billion in mortgage-backed assets owned by two **structured investment vehicles** it manages, the biggest bail-out so far of such funds. SIVs borrow short-term to buy high-yielding securities and are having a hard time raising money.

**E*Trade**, a discount broker which has expanded into mortgage securities and credit facilities, received a $2.5 billion cash infusion from a hedge fund.

**Northern Rock**, a distressed British bank, named a consortium led by Sir Richard Branson's **Virgin Money** as the preferred bidder to take it over. The consortium promises to pay back immediately £11 billion ($23 billion), or almost half, of the money lent to Northern Rock by the Bank of England in a rescue package. Northern Rock shareholders objecting to Virgin's deal threw their support behind a rival bid being mooted by Olivant, a private-equity firm. See article

## Owning a debt

**KfW**, a German development bank, said it was putting aside an extra *euro*2.3 billion ($3.4 billion) to cover losses at **IKB Deutsche Industriebank**, in which it holds a 38% stake, because of a deteriorating situation in its exposure to the American subprime-mortgage market. KfW led a group of German banks in rescuing IKB in the summer after the lender revealed large losses.

**Ping An Insurance**, a Chinese insurer, took a 4.2% stake in **Fortis**, a Belgian-Dutch financial company, becoming its largest shareholder. Chinese finance companies are estimated to have spent around $17 billion this year buying stakes abroad, including some in Blackstone Group, Bear Stearns and Barclays.

Three British bankers accused of fraud in a case connected to the collapse of Enron reached a plea-bargain deal with prosecutors in America. Each said he was guilty of wire fraud. The so-called **"NatWest Three"** had fought their extradition to the United States for two years. A sentencing hearing is scheduled for February.

## National interests

A consortium led by **British Airways** and **TPG**, an American private-equity firm, abandoned its effort to buy **Iberia**, Spain's biggest airline. **Caja Madrid**, a state-controlled Spanish bank, recently increased its stake in Iberia, which some observers say was intended to stymie the foreign bid. See article

**Rio Tinto** unveiled a package of measures, including a boost to its share dividend, that bolsters its defence against **BHP Billiton's** proposed takeover. It also reasserted its belief that the opening offer price is undervalued. BHP Billiton remained confident about the success of its bid to combine with Rio Tinto, and so create a $350 billion mining giant.

The group that owns **Yorkshire Water** agreed to a £3 billion ($6.2 billion) buy-out from a consortium. Several British water utilities, viewed favourably by investors because of their comparatively stable returns, have been bought out this past year.

**Philips**, a Dutch consumer electronics company, said it would buy **Genlyte**, based in Kentucky, for $2.7 billion. The deal vaults Philips ahead of General Electric in the share of America's lighting market and adds

to its presence in the country's expanding market for energy-saving light bulbs. See article

**Deutsche Telekom** terminated its high-profile **sponsorship** agreement with Team T-Mobile, citing the potential damage to its brand from the recent revelations about doping in professional cycling.

**House prices** in Britain fell in November by 0.8% compared with October, the sharpest drop in more than 12 years according to a survey from Nationwide Building Society.

## Yuletide blues?

**Consumer confidence** in America plunged in November to reach its lowest level since just after Hurricane Katrina in 2005. The tumult in financial markets and the prospect of higher heating bills fed the despondency. Retailers hope that the season of goodwill will imbue consumers with optimism: sales in the post-Thanksgiving weekend, which kicks off the holiday spending spree, rose by 6.5% compared with last year. However, analysts still expect sales to drop in total in the run-up to Christmas.

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# KAL's cartoon

Nov 29th 2007
From The Economist print edition

Illustration by Kevin Kallaugher

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The dollar

# The panic about the dollar

Nov 29th 2007
From The Economist print edition

**A full-blown dollar collapse would be disastrous. Thankfully, it need not happen**

THE weather may be cold and wet, but in the rich world's financial markets it is beginning to feel like August all over again. Credit spreads have widened and shares are pitching from gloom to elation as investors look to the Federal Reserve for solace. The anxiety is unmistakable. But this time the scare is about more than bad mortgage loans and their baleful effect on the credit markets. America may be falling into recession. And a new fear now stalks the markets: that the dollar's slide could spin out of control (see article).

A full-blown dollar crisis on top of a credit crunch and a weakening economy would be frightening. It would send financial markets reeling and tie the hands of the Fed, perhaps forcing it to raise interest rates even as recession looms. The sky-high euro would soar further, choking off Europe's growth. Political tensions would also rise. Already Airbus has called the dollar's decline “life-threatening” and France's president, Nicolas Sarkozy, has given warning of “economic war”.

At worst, the shadows could darken further. For half a century the dollar has been the hegemonic currency. A large slice of global trade is counted in dollars. Central banks hold most of their foreign-exchange reserves in dollars, a boon for America that has allowed it to issue debt more cheaply. That dominance has survived dollar slides before, as in the late 1970s and mid-1980s. But now, with the euro as an alternative, the fear is of a sudden shift in the global monetary system, with investors switching quickly from one currency to the other.

So far, this remains only a fear. Although the dollar has been falling at quite a lick—down 6% against a trade-weighted basket of currencies since August—it has seen no chaotic slump, but a slide interspersed, as this week, with brief rallies. Americans' expectations of future inflation have not yet risen much. Yields on government bonds have fallen: clearly, investors do not yet expect higher premiums for safe American assets. Whether disaster strikes depends on what exactly is driving the dollar down and on how policymakers react.

## Headwinds and tailwinds

Much of the dollar's weakness is driven by economic fundamentals. Since peaking in 2002, it has fallen by 24% against a trade-weighted basket of currencies. Given America's need to borrow from abroad to finance its consumption, that is neither surprising nor sinister. By inducing Americans to import less and export more, a weaker dollar helps cut the current-account deficit. For America, the medicine has been

working—the deficit is down to 5.5% of GDP from a peak of almost 7%.

If the dollar's decline has accelerated of late, that is largely because of the cyclical divergence between America's economy and the rest of the world. America fears recession; the Fed has already cut interest rates by 0.75 percentage points and financial markets are convinced that it will cut another quarter point on December 11th, when it next meets. When America's growth prospects and interest rates fall relative to those elsewhere, a cheaper currency is inevitable.

But economic fundamentals are not all that is hurting the dollar. The currency is also suffering because the credit mess is concentrated in dollar assets. Investors' conviction that transparent markets and vigilant regulators make America a safe place to store money has taken a battering from the revelations of recent weeks. Net private capital inflows into America seem to have evaporated since the credit turmoil began. The subprime crisis has tarred the dollar as a subprime currency.

In recent years a fall in private inflows has usually been offset by central banks in emerging economies that link their currencies to the dollar. This system (often known as Bretton Woods II) has thus propped up the dollar. But this time these central banks have been less willing to take up the slack. Right on cue, the cracks in Bretton Woods are becoming clear. China is routinely attacked in America and Europe for linking its currency to the dollar. Squeezed between rising oil prices and the falling dollar, the Gulf states face rising inflation: speculation is rife that one or more of them will modify their currency pegs at a regional meeting on December 3rd.

## Handle with care

There you have it: the ingredients of a nasty crash. But self-interest and sensible policy can cut the odds of trouble. The first step is for American policymakers to pay more heed to their currency. For all their talk about a strong dollar, American officials have behaved as if they cared little about its worth. A reserve currency is supposed to be a store of value; by running a huge current-account deficit America has left the dollar vulnerable. At such a tricky time, benign neglect will no longer do. For the moment, this need mean little more than some carefully chosen words. If the slide becomes chaotic, it could demand currency-market intervention and a willingness to hold back interest-rate cuts for the sake of the dollar.

The other part of the solution lies elsewhere, particularly with those countries with dollar-pegging currencies. These economies need to allow their currencies to rise, both to curb inflation and encourage the rebalancing of the global economy. Appreciation would mean that these countries accumulated new dollar reserves at a slower pace. That in turn would lead to a loss of the dollar's pre-eminence and the emergence of other reserve currencies: there is no rule to say you can have only one reserve currency. But this need not—and in today's febrile environment must not—mean dumping existing dollar reserves. That would impose a far higher cost on everyone, including the dumpers.

The history of international co-operation on currencies is patchy. But China and the oil-rich Gulf states have ample reason to play their part in an orderly decline of the dollar's dominance. Despite the opprobrium heaped on them, the Chinese do not want to see the Fed's hands tied by a dollar crisis; nor do they want to see the euro zone, one of their best markets, slow sharply; and they have little interest in the external value of their existing dollar reserves plunging. Beyond all that, China's leaders want to be taken seriously as responsible actors in the international system. Now is their chance.

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The Annapolis peace summit

# Much to be modest about

Nov 29th 2007
From The Economist print edition

**George Bush sent the Palestinian moderates home with little to show and less to sell**

Reuters

BETTER than nothing. For now, that is the most that can be said of the new Arab-Israeli “peace process” George Bush inaugurated in Annapolis on November 27th. After weeks of negotiation, the Israeli and Palestinian delegations did at the last minute approve 437 words for the American president to read out, but this was the sort of declaration that makes the phrase “lowest common denominator” sound generous. It commits both sides to the goal of two states but is utterly silent on borders, Jerusalem, Israel's West Bank settlements and the fate of the Palestinian refugees—all the issues, in fact, that have confounded previous bouts of peacemaking.

The pious hope of this newspaper that America's president might fill the gap was confounded too (see article). Annapolis showed that for all its woes in the Middle East the United States still has pulling power. Saudi Arabia, Syria and a dozen other Arab countries turned up. Had Mr Bush wanted to signal what sort of deal America wanted, this was his chance. Yet his own speech was almost miraculously content-free. There was the ghost of a reference to 1967 and a call for Israel to stop expanding settlements. But saying out loud (as Bill Clinton did) that the border would have to be based on that of 1967, or that the two states would have to share Jerusalem, was evidently too daring for this deadbeat White House.

So Mahmoud Abbas, the Palestinian president Annapolis was intended to strengthen against the rejectionists of Hamas, returns to Ramallah with little to show except the promise of a year of bi-weekly meetings with Ehud Olmert. He has already met the Israeli prime minister umpteen times and they have been unable to agree on any of the substantive issues. Mr Olmert may feel that he came out better from Annapolis. But what a barren victory: how can he or any other Israeli centrist persuade Israel's religious hawks to accept the need to give ground on Jerusalem, for example, while America has a president who is not willing to make such a demand?

It is of course better that the two sides talk, even if their chances of making a breakthrough unaided are nil. Talking is better than killing. Talks might also prepare the ground for the day when America does have a president who is genuinely willing to spend political capital on Palestine. Having a peace process under way should also make it easier to take practical steps to improve the economic conditions of the Palestinians.

## And it could get worse

On the other hand, history teaches that the start of even unpromising peace talks galvanises the spoilers from both sides. Right now, with the Gaza Strip under the control of Hamas, the prospects of escalation are all too real. As soon as one of the many rockets that Hamas fires routinely and indiscriminately into

Israel's southern towns hits a school or synagogue and kills a large number of Israelis, Mr Olmert will come under intense pressure to send his army back into the Gaza Strip, from which Ariel Sharon controversially extracted it in 2005. That could lead to a war no less brutal than the one Israel fought against Hizbullah in Lebanon last year.

In the White House, Mr Bush's speechwriters are no doubt congratulating him on a good week's work. They appear to think that simply attracting a big crowd of Arabs to Annapolis and talking loftily about an independent Palestine strengthens the region's moderates against the extremists of Hamas and Hizbullah, and the Iranians behind them. But in asking Mr Abbas to lead his exhausted and sceptical people back into the tunnel of negotiations, and neglecting to switch on a light at the end of it, Mr Bush is asking a lot of the Palestinian moderates. If they fail, he will deserve a big share of the blame.

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Australia's political upheaval

# A lucky country to run

Nov 29th 2007
From The Economist print edition

**Kevin Rudd owes John Howard a lot; he may also prove to be a success**

AFP

AS ANY sports fan knows, Australia loves a winner. So to the outsider it is a shock that its voters on November 24th so decisively turfed out the government led for more than 11 years by John Howard (see article). Much the most successful prime minister of modern times, he had led Australia into what will be its 17th consecutive year of economic growth—probably of more than 4% this year. Moreover, the Labor opposition to him seemed, not that long ago, a shambles—divided, old-fashioned and led by losers. The leader it elected a year ago, Kevin Rudd, a rather geeky former diplomat, looked an unlikely challenger to the wily, combative and ruthless Mr Howard.

In electoral terms, Mr Rudd has now shown himself a winner. To prove so in government, he needs to learn from Mr Howard's success, as well as Labor's recent failures. The early signs suggest he has grasped the most important lessons.

The first is to demonstrate independence from the party's factions and the trade unions. The most damaging charge laid against Labor by the government's campaign was that 70% of its cabinet would be trade-union officials. By declaring that he, rather than Labor members of parliament, will appoint his cabinet, Mr Rudd jettisoned a century-old tradition, and made clear that the top man and not murky powerbrokers will call the shots. Similarly, on economic policy, Mr Rudd has been at pains to present himself as the heir to the liberalisation launched by the Labor government of the 1980s and pursued by Mr Howard, rather than as an old-fashioned tax-and-spend trade unionist. He has called himself a “fiscal conservative”, and claimed his spending promises—lavishing resources on education, renewable energy and a national broadband network—would cost less than Mr Howard's commitments. He managed to portray Mr Howard, whose party stands for small government and free markets, as a spendthrift, and a too-ideological one at that, offering a hefty tax rebate to anyone—however well-off—who educates their children privately.

The big exception to Mr Rudd's pledge of economic continuity is a promised reform that won Labor many votes: the revision of Mr Howard's unpopular “WorkChoices” industrial-relations legislation. This shredded the last vestiges of trade-union power in the workplace, shifting workers on to individual employment contracts. But even here, Mr Rudd has been careful not to bind himself too tightly to the old orthodoxies. Reform will be slow, and many of the measures introduced by the government to limit union power will be retained. Voters were probably right not to buy Mr Howard's claim that the changes will cost 200,000-400,000 jobs.

The third lesson involves the relationship with America. The election confirms the Bush effect. Mr Howard's role as George Bush's “deputy sheriff” may have seemed a comfort a few years ago. In this campaign, however, it was a liability. Australians wanted to see clear blue water between their country

and the American flagship. Mr Rudd's commitment to withdraw Australian combat troops (though not other army personnel) from Iraq starting next year was popular.

However, it would be worrying were Mr Rudd to distance himself too far from America—especially if it was part of a reluctance to offend China. The latter is now Australia's biggest trading partner, and, through its inexhaustible demand for commodities, the engine of Australia's prolonged boom. Balancing that relationship with the American alliance is the central task of Australian foreign policy.

Mr Rudd, who worked in China and speaks Mandarin, opposed a security pact that Australia signed with Japan in March. But he has also expressed support for the American- and NATO-led operations in Afghanistan. On winning the election, he was quick to stress the “centrality” of America to his foreign policy. Mr Bush was one of the first leaders to call him. This is an alliance not in trouble, but in electoral nuance: Gordon Brown will understand.

## The changing political climate

Mr Rudd has also learned what many national leaders elsewhere will discover in the next few years: that climate change is now an election issue. A few years ago Mr Howard could get away with his robust refusal to sign up to the Kyoto protocol, to hobnob with Al Gore or do anything that might damage Australia's booming coal industry. No longer. This may have been one of the first national elections in which global warming was a political issue for big parties. It will not be the last.

Mr Howard was perhaps in office too long to sense that. Unlike Tony Blair or Margaret Thatcher in Britain, he was not dumped by his party after a successful decade. It was left to the electorate. The climate-change debate points to a broader electoral truth: nations like to feel proud of themselves. Winning, in fact, is not enough, even in Australia: you have to do it right. That was the mood that Mr Rudd adroitly captured. When the Liberals were caught distributing fake propaganda depicting Labor as soft on Islamist terrorism, it confirmed an image of the party as abrasive: so sharp it would cut itself. Mr Rudd, by contrast, came across as Mr Howard with the rough edges sanded off. If so, Australia could do much worse.

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Economist.com OPINION LEADERS

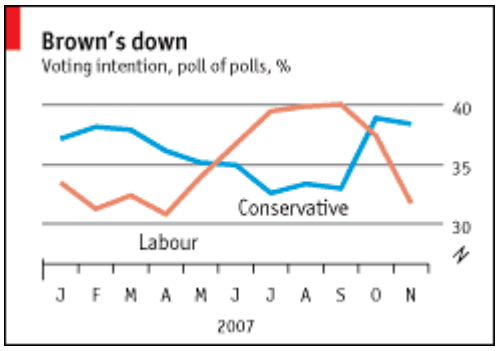
British politics

# Labour pains

Nov 29th 2007
From The Economist print edition

**Gordon Brown has discovered yet another hole to fall into; his way out of it remains the same**

Gordon Brown




AS BRITISH political scandals go, this one is not particularly juicy. No honours seem to have been sold, no politician's Parisian hotel bills picked up, no extramarital toes sucked. But the revelation that a rich businessman disguised contributions to Britain's governing Labour Party of more than £650,000 ($1.3m) over four years under other people's names, and that the party failed to report it (see article), is one the embattled Gordon Brown could well have done without.

Two months ago, when the prime minister ducked out of calling an election, stupidly insulting Britons' intelligence by claiming that opinion polls had not influenced this decision, the hope was that he would provide sturdy, efficient government. Instead, as Vince Cable, the Liberal Democrats' increasingly witty stand-in leader, put it, the once feared Mr Brown has gone from Stalin to Mr Bean. The cackhanded rescue of Northern Rock, a troubled bank, showed regulatory weakness and poor judgment under fire. Ill-thought-out proposals to change the tax code have drawn business groups together against the government. The tax authority's loss of 25m people's personal details revealed unimaginable administrative bungling. A trio of retired generals launched a mutiny in the Lords, protesting against cuts in military spending: being armed-forces minister is, they claimed, a part-time job. Now there are the multifaceted donations from David Abrahams; Peter Watt, Labour's general secretary (and its previous head of compliance), has already resigned.

None of this means that Mr Brown is headed irrevocably for the exit. Yet governments can reach a tipping point after which they find it impossible to govern. People neither like nor trust politicians, but usually suspend their disbelief when a new lot takes over. Once it seems clear that a prime minister is unlikely to improve things, and may not even be around for long, that suspension is over: the civil service starts leaking; cabinet ministers start briefing; the press looks for bad-news stories; and government becomes defensive and unfocused.

In one way, Mr Brown's position is particularly difficult, because unlike other political leaders he cannot claim to be a new broom. Much though he would like to disown Tony Blair, he was his senior lieutenant. The problems to do with Northern Rock and the tax-authority records, for instance, are linked to decisions Mr Brown made as chancellor of the exchequer. And even when he was not directly involved in Blairish mishaps—such as the long "cash for peerages" inquiry into political-party funding—voters may well assume he was.

## The bishop, the judge and the embattled prime minister

Yet Mr Brown's predicament is not quite as bad as it looks. The gaffes are not as appalling as the Tories are making out. As with Mr Bean, no one has died, or been swindled outright. And the remedy, painful though it may be, is to provide what Mr Brown's natural Stalinist tendencies have always promised: reliable, sound and slightly brutal government.

The new fuss about political donations is a good example. The Garboesque Mr Abrahams, who compares his donations to his charitable giving, says he wished no public recognition for his benevolence. That may be so, but the decision was not his to make. The laws against anonymity for big political contributors are clear and they exist for a clear reason: the public is entitled to know who may be buying access to those who rule the land. Mr Watt, who says he knew of Mr Abrahams's arrangement but not that it was illegal,

will obviously face some close questioning; so will Jon Mendlesohn, Labour's chief fund-raiser who was told about the dodgy donations in October. But so far Mr Brown is not involved: there is nothing to suggest that he knew of these convolutions, even though the bulk of the payments were made after he took office in June.

So far the prime minister has done half the job. He was quick to condemn his party's breach of the law, but he diluted that decisiveness by reaching for a familiar tool, a committee of inquiry into the matter—led, for good measure, by a retired bishop and a judge. In this case, the “lessons to be learned” are not complicated. If the law has been broken, it is a matter for the police. Besides, there are other things that Mr Brown needs to do, such as finding a permanent chairman for the independent Committee on Standards in Public Life, which has been without one for six months, and pressing ahead with genuine reform of political-party funding.

That would require hard-up Labour to co-operate with the Tories and perhaps give up its special financial relationship with the unions—bitter pills for a partisan like Mr Brown. But he should face some partisan facts. The Conservatives now have a decent lead in the polls; he has two years to win back voters; and the only way he can grind out a victory is through unimpeachable probity and solid competence.

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Russia's parliamentary election

# United to win

Nov 29th 2007
From The Economist print edition

**The election this weekend will be neither free nor fair, and the West should say as much**

AFP

AN ELECTION, as the word implies, must offer a choice. Yet there is no real choice for voters among candidates for the Russian parliament on December 2nd. So this is not a genuine election, and its results will be largely meaningless. Thanks to arbitrary rule changes, the state's monopoly grip on the broadcast media and the harassment and arrest of even insignificant groups of protesting opponents, United Russia, the pro-Kremlin party with President Vladimir Putin now at its head, will win by a mile. The Communist Party will gain a handful of seats, for old time's sake. Perhaps one other party will also be helped over the 7% threshold for representation.

This is not democracy; it is politics as tragi-comic farce, and it should be recognised as such. The Organisation for Security and Co-operation in Europe (OSCE) was right to respond to Russia's attempt to slash the number of election monitors that it would admit, from over 400 in 2003 to only 70 this time, by refusing to send any observers at all. It would have been better had parliamentarians from the OSCE and the Council of Europe decided, similarly, not to go. In the present climate of brutality towards any opposition, there is no chance whatever of this election (or, indeed, the presidential election due in early March) being conducted in a free and fair way. The despatch of any international observers risks being exploited by Moscow to lay a false veneer of credibility over a sham.

The strangest thing about the Kremlin's heavy-handed behaviour is that it is to a great extent unnecessary. Polling evidence in today's Russia is hardly reliable, but all the signs are that Mr Putin is genuinely popular with ordinary voters. The Russian people like the apparent stability and rising living standards that they have enjoyed over the past eight oil-fat years. They care little for the liberal opposition, which they associate with the chaos, poverty and oligarch-creating 1990s under Boris Yeltsin. Most Russians want Mr Putin to stay on as president when his second and (under the constitution) final term as president is up next March.

And here lies the explanation for much of the Kremlin's recent behaviour. What has been going on in Russia, both in the parliamentary election and beyond, is not a popular political contest but a factional struggle over how Mr Putin can best retain his grip on power, and who should be his ostensible successor. As ever, Moscow is full of gossip and rumours about the answers. At this stage it is unwise to rule anything out, although it seems unlikely that Mr Putin will now change the constitution to allow himself a third term. More plausible is the notion that he may become prime minister, and install a yes-man as president (perhaps his most recent choice as prime minister, Viktor Zubkov) before finding some way of taking back the top job for himself (see article).

## Do not exit, pursued by a bear

The dangerous uncertainty that always accompanies a transfer of power in the sort of autocracy Russia is becoming does much to explain why the government's rhetoric has taken such a markedly anti-Western turn. Mr Putin has angrily denounced his opponents for taking “foreign” money. He has accused the West of blatantly interfering in the election. Even more ludicrously, this week he blamed the Americans for the OSCE's decision not to send election monitors, claiming that it was a plot to discredit the poll. In truth, attacking foreigners is just an easy way to stir up nationalist support.

How should the West respond to all this? Any answer should begin by accepting that the West's influence on Russian internal politics is likely always to be small. In any case realpolitik points towards some political engagement with Russia, however distasteful its government may be. Russia will continue to play a big role on the international stage over such topical issues as arms control, Iran, North Korea and Kosovo—besides being Europe's most important supplier of energy.

Yet it would be wrong to see the West's lack of influence and the need to talk to Russia as reasons to say and do nothing about its march towards autocracy. Appeasing Russian leaders in the past eight years has not made them more accommodating of Western interests. Moreover, for all his foreigner-bashing, Mr Putin has shown that he craves international respectability.

He should no longer get it. Western political leaders must not hesitate to condemn the conduct of this weekend's election. They should exclude “elected” Russian deputies from the Council of Europe's parliamentary assembly, a supposedly democratic club. And it is surely time to reconsider Russia's membership of the G8 club of rich democracies. Failure to denounce this weekend's sham election would serve only to discredit the West and dishearten those brave Russians who still hope for a democratic future.

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Business in Japan

# Tuning the hybrid

Nov 29th 2007
From The Economist print edition

**Corporate Japan has devised a new industrial model, but further reform is still needed**

HOW much has corporate Japan changed in the past decade? A great deal, say optimists, who point to all the things that are different; not enough, say pessimists, who point to everything that has stayed the same. Both are right. In recent years Japanese companies have emerged from the gloom of the 1990s with the help of a new industrial model that combines elements of the old Japanese way of doing things with some carefully chosen bits of American capitalism.

As our special report in this issue argues, the result is a hybrid, an effort to achieve the best of both worlds—rather as a Toyota Prius combines the range of a petrol engine with the energy efficiency of an electric motor. Many Japanese companies now provide merit-based pay and share options, for example, but not to the extent that American firms do. There is more shareholder activism and more mergers and acquisitions, but activists and acquirers are expected to be polite. And although the older salarymen get to keep their jobs for life, the young are less inclined to offer to “bury their bones” at the company that first hires them, and are keener on playing the market and moving around.

All of this is to be welcomed, and much of it has been made possible by a steady flow of reforms. But the emergence of the new hybrid model has been accompanied by the worrying creation of a two-tier labour market. The share of “non-regular” workers—which includes temporary, part-time and contract workers—has risen from 19% in 1989 to 33% today. Non-regular workers generally earn less than half as much as “regular” workers do, and are denied the generous perks and social-insurance coverage that such insiders receive.

During the 1990s companies placed a greater emphasis on non-regular workers, often reducing or freezing the hiring of regular workers, in order to reduce costs. But this tactic poses a long-term threat both to companies and to the economy as a whole. Non-regular workers receive little training, so that Japanese firms run the risk of ending up with a cohort of unskilled, middle-aged non-regular staff. And their low pay is one of the factors that has helped to hold down domestic consumption, making the Japanese economy's moderate recovery in recent years heavily dependent on exports—something that is now the cause of great concern, particularly as demand overseas for Japanese goods weakens.

Japan prides itself on being an egalitarian society. In a survey carried out in 1987, 75% of the population identified themselves as middle class. By last year the figure had fallen to 54%, and the number of people who identified themselves as below middle-class had risen from 20% to 37% over the same period. Worries over rising inequality were cleverly exploited by the opposition in the upper-house elections this summer, which led to the downfall of the prime minister, Shinzo Abe. His successor, Yasuo Fukuda, has pledged to continue along the path of reform while addressing inequality.

The best way to do that would be to focus on further reforms to the labour market, and in particular to reduce the lavish employment protection granted to regular workers, which is one of the reasons why firms hire non-regular workers instead. At the same time, business needs to extend some social-insurance schemes to cover non-regular workers, and improve conditions for non-regular workers with such things as better child-care provision and more training.

## And the rest will follow

Some companies have already responded to Japan's moderate recovery by shifting some non-regular

workers into regular positions. Other firms should be encouraged to do the same. As well as addressing inequality, this could help to boost consumption. Reducing the protection offered to regular workers would make corporate restructuring easier. And better terms for non-regular workers would encourage more women to enter the workforce and more older people to keep working in semi-retirement, both of which will be necessary as Japan's population ages and the workforce starts to shrink. Entrepreneurship would benefit, too. At the moment anybody in a regular job who has an idea for a new company has a very strong incentive to shelve his idea and stay put. The labour market is, in short, the point at which Japan's various problems overlap, and where further reform is now most urgently required.

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# On religion and public life

Nov 29th 2007
From The Economist print edition

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## Don't mention God

SIR – Your leader on religion and public life concluded that "politicians must learn to take account of religious feelings and to draw a firm line between church and state" ("The new wars of religion", November 3rd). But the problem with giving religion space in "the public square" is that religionistas will take it as confirmation that their beliefs give them a right to control a person's behaviour. Whether they are jihadist Muslims, busybody Christians, political Hindus or Buddhists, they will conclude that they can tell me what I can and cannot do. Personally, I couldn't give a damn if they believe in the Great Green Tomato so long as they leave me alone.

Alas, the business model in the oddly Darwinist world of competing proselytising religions you highlighted in your special report (November 3rd) seems to make it mandatory for religionistas to wake me up on a Saturday morning to ask if I have accepted Jesus or the Angel Moroni as my saviour. It also means that friends of mine who happen to love a person of the same sex can't visit their critically ill partner in certain hospitals, nor benefit from the largesse we confer on people who happen to love someone of the opposite sex. I suppose they should be grateful not to live in those places that push stone walls over on the evil homos.

H.R. Webb

Seattle

SIR – By calling for a "firm line" between church and state you essentially denied the power and importance of religion in many people's lives across the globe. While you rightly pointed out that religion can be used as a tool to motivate violence, you neglected the power it has to create peace. Religion has the ability to bridge divides through empathy and forgiveness. Religious organisations also have natural advantages over the secular kind. They are effective organisers in the community with extensive networks, and in most places people trust them more than politicians. We should embrace, not isolate, those religious leaders who are ready to use their faith to mobilise communities around peace.

Marci Moberg
Scott Cooper
Arlington, Virginia

SIR – It is wrong to say that the United States Commission on International Religious Freedom, a bipartisan body, has not addressed Iraq until recently. We have provided detailed reporting, monitoring, legal analysis and recommendations on Iraq since before the fall of Saddam Hussein. The commission urged the Bush administration in April 2003 to promote an Iraqi political system built on the right of every Iraqi to freedom of thought, conscience, religion and beliefs.

We cautioned then that "the horrific repression of the previous regime could be replaced by ethnic and sectarian violence and by egregious violations of religious freedom and other human rights against members of Iraq's diverse religious communities."

Michael Cromartie
Chair
United States Commission on International Religious Freedom
Washington, DC

SIR – You implied that rabbis who do not speak out when Israeli rockets fall on Palestinian civilians are

equivalent to imams who do not condemn suicide-bombers in Israel. This misses a crucial difference: Israeli civilians are the targets of suicide-bombers while the tragic deaths of Palestinian civilians are never intended by Israeli forces.

Menachem Kellner
Haifa, Israel

SIR – I was disappointed that you incorrectly described the Sri Lankan conflict as Buddhist versus Muslim. War there has been waged between the Sri Lankan government, tending to represent the interests of Sri Lanka's majority, and predominately Buddhist, Sinhalese ethnic group, and the Liberation Tigers of Tamil Eelam, who claim to represent the mostly Hindu Tamil minority. Muslims constitute the third-largest ethnic group in Sri Lanka and they have been caught in the crossfire. By and large they have not resorted to arms (just like most Muslims worldwide) and should be lauded for their peaceful attempts to defend their community.

Susan Hayward
Washington, DC

SIR – Demographic issues were largely absent in your special report. The religious right would be moribund if the fertility of conservative Protestants in the 20th century was the same as that of non-religious Americans. Instead, it was twice as high.

In Western Europe secularism would be the undisputed champion were it not for migration. Most Christians in London are non-white; each week Muslim worshippers outnumber those from the Church of England. Secularism must run just to stand still.

Eric Kaufmann
Reader in politics and sociology
Birkbeck College
London

SIR – The rise of religiosity in America has coincided with the movement of the population away from inner cities to the suburbs. People living the relatively isolated “good life” naturally seek engagement with their neighbours, and one of the few mechanisms for regular interaction in the suburbs is the church. Many people attend church for social reasons initially, not to satisfy a spiritual need.

Thomas Naypauer
Cleveland

SIR – Since we secular humanists have zero population growth and cannot compete demographically with the “hot”, ie, fundamentalist types, we'll have to out-proselytise them. Sam Harris, Richard Dawkins, Daniel Dennett and Christopher Hitchens are in the new vanguard of authors articulating atheism (Mr Harris thinks that people who are more moderate in their religion still do harm through a religious habit of mind that is no less irrational than fundamentalism). As you pointed out, the proportion of Americans saying they have no religious preference has doubled, to 14%, and the total number of non-believers worldwide is “enough to make atheism the fourth-biggest religion”.

Erik Honda
San Francisco

SIR – It is interesting that you observed how the pronouncements of Iran's President Mahmoud Ahmadinejad have a similar ring to words spoken by Oliver Cromwell. As an aside, the late Judge Learned Hand, who sat on America's court of appeals, always said he would liked to have seen some particular words written by Cromwell placed over the portals of every church and courthouse and at every crossroads across the nation. The words are: “I beseech ye, in the bowels of Christ, think that ye may be mistaken.”

Judge Hand thought that if we are to be saved it must be through scepticism. Or, as he once summed it up: “The spirit of liberty is the spirit that is not quite sure it is right.”

Carolyn Morillo
Port Angeles, Washington

SIR – There is an error of fact in your special report. Adam and Eve did not meet “6,003 years ago”. The world was created in 4,004BC. It may have failed to come to an end after 6,000 years in 1996, but the date of creation never budged. The mother and father of us all actually met 6,011 years ago. Archbishop Ussher wrote it, I believe it, that settles it.

Budd Whitebook
Washington, DC

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The City of London's tumble

# After the fall

Nov 29th 2007
From The Economist print edition

KOBAL

**Britain's most spectacular moneymakers have tripped up. Over the next year or so, the fall will hurt not just them but Gordon Brown and the rest of the country too**

“I WOULD rather see finance less proud and industry more content,” said Winston Churchill in 1925, shortly before he took the fateful decision to subject Britain's northern manufacturing heartland to an overvalued pound by returning to the gold standard. Over the past decade finance has seldom been more proud—and nowhere more so than in the booming City of London. Once again industry has been the poor relation, suffering from the strength of sterling, while northern regions have fallen further behind a more prosperous south.

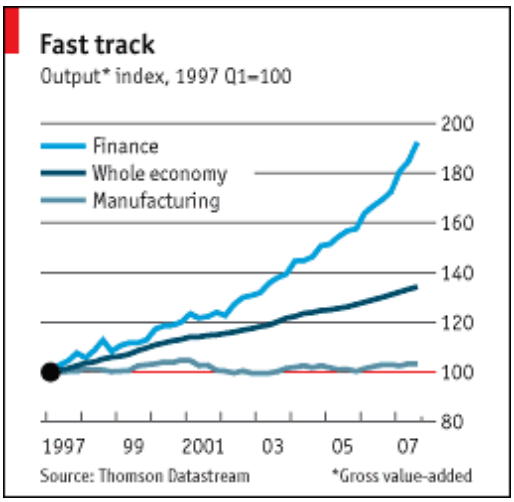
This autumn the proud City has taken a fall. Bank shares have fallen by nearly 20% since the summer as investors worry about potential losses linked to dodgy mortgages in America. Banking jobs are being axed and financiers are no longer looking forward to the usual Christmas cheer of bumper bonuses. Yet in a bleak irony, the biggest casualty to date has been in Newcastle, the north-eastern base of Northern Rock. The mortgage lender's woes have undermined confidence in the ability of one of Britain's poorest regions to build a post-industrial future.

No one can gauge yet quite how serious the City setback will be or how long it will last. Although a prolonged banking crisis, such as the one that crippled the Japanese economy in the 1990s, cannot be ruled out, the current difficulties are still most likely to be a temporary reverse. Yet the impact over the next year or so will be painful, not only for those who work in the City but also for the economy and the public finances. As the shockwaves ripple out from London's financial district, they could undermine the regional foundations of Labour's long electoral hegemony.

Over the past decade, financial services have grown much faster than the economy as a whole, whereas manufacturing has barely grown at all (see chart). At the start of this decade, the financial sector—banking and securities, insurance and specialist services like shipbroking—made up 5.5% of national output; by 2004 that share had jumped to 8.3%. Over the same period manufacturing dwindled from 17.9% to 14.1%. The financial sector's expansion has continued apace: by 2006 it made up 9.4% of the economy, according to provisional official estimates.

Finance is more important to the economy in Britain than it is in other countries. What makes the difference is the City's role as a global financial hub, where leading banks and moneymen congregate to do business with one another. As a centre for international finance, London heads the league. Its foreign-

exchange markets are huge, with over twice New York's share of trading; it dominates off-exchange dealing in derivatives; and last year it hosted the most new share issues, by value. London's specialist wholesale financial services and markets, which now extend well beyond the historic “square mile” round St Paul's Cathedral to encompass Canary Wharf in the east and Mayfair in the West End, make up a third of Britain's financial sector.




The recent City-led expansion of finance in Britain has meant that a sector worth almost a tenth of the economy has been responsible for 30% of overall GDP growth over the past three years. The unpleasant corollary is that the financial crisis will apply the brakes. National output is expected to expand by about 3% in 2007. But according to CEBR, an economic consultancy that monitors the City, GDP growth will decrease in 2008 to 1.4%, its slowest since 1992, as banks curb their lending and trading activities.

Although most other forecasters are less gloomy, the government has good reason to worry about a finance-led economic downturn. In the past decade Britain's financial sector has contributed about 30% of all corporation-tax revenues. For all the attention devoted to how some escape their fair share of taxes, the taxman has also reaped handsome returns from the City's high fliers, who make up many of the top 1% of earners contributing 22% of income-tax receipts. The fiscal dividend has been vital in paying for Labour's big public-spending increases.

But now the deteriorating fortunes of the financial sector threaten the health of the public finances. Alistair Darling, the chancellor of the exchequer, conceded in October that borrowing would overrun by £4 billion ($8.3 billion) in 2007-08 and £6 billion in 2008-09, raising the total budget deficit to £38 billion and £36 billion respectively. But these higher estimates, representing the Treasury's first stab at the impact of the banking crisis, may still be too optimistic. The government has got its sums wrong about revenues from the financial sector before, points out Robert Chote, director of the Institute for Fiscal Studies, a think-tank. It was wrongfooted by the dotcom crash in Labour's second term, when revenues fell by more and for longer than it had expected.

## Changing the mix

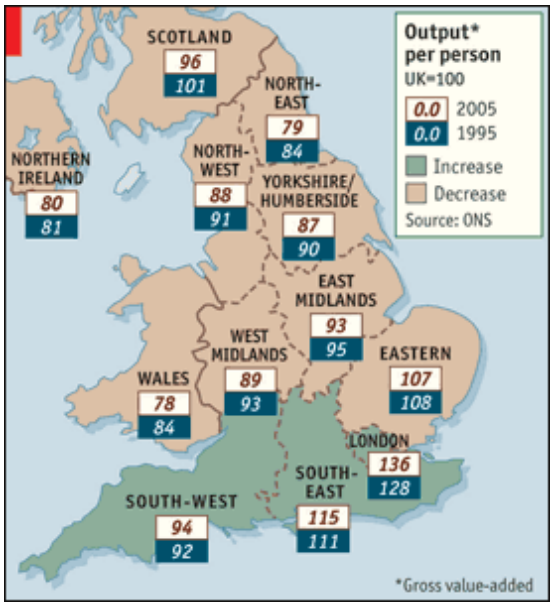
A finance-led downturn will have wider social consequences too. London acts as a huge turntable, sucking in migrants from abroad but spinning out existing residents to the rest of the country. As the City slows, so too will its demand for foreign labour. After several years in which national immigration figures have been higher than expected, next year's may surprise by coming in lower than expected. “It is pretty certain that if the London economy does hiccup there will be a slowdown in immigration to Britain,” says John Salt, head of the Migration Research Unit at University College London.

London may also become less popular with rich foreigners, who have given it an increasingly plutocratic feel in recent years. With less money to be made, some may be put off staying by the prospect of having to pay a special annual charge of £30,000 from April 2008 if they claim non-domicile status, which protects foreign income from taxation so long as it is not remitted to Britain. The “non-dom” tax will affect only those who have lived in Britain for seven or more years but it already seems to be affecting sentiment.

The most important effect of the City slowdown may be to change the regional balance of economic advantage, which poses a potent political threat to the current government. After Labour's fourth successive defeat at the polls in 1992, Giles Radice, then one of its MPs, wrote an influential pamphlet called “Southern Discomfort” arguing that the party would continue to fail so long as it stayed stuck in its northern strongholds and put off the aspirant voters of the south. Tony Blair got the message and won a landslide in 1997 by wooing southern voters still smarting from the economic pain of the housing crash in the early 1990s. He won another thumping victory in 2001, as London and the south thrived in Labour's first term.

The surge in southern prosperity over the past decade has been greatest in London. In 1995 output per person in the capital was 28% higher than the British average; by 2005 it was 36% greater. Only two other regions gained ground: the south-east (11% above the national average in 1995; 15% above it in 2005) and the south-west (8% below the national average in 1995; 6% below it in 2005). Scotland,

Wales, Northern Ireland and the other six regions in England (essentially the Midlands and the north) all lost ground (see map).




Not only is London one of Europe's most prosperous regions, but also it is one of the biggest city economies in the world. In a recent ranking by PricewaterhouseCoopers (PWC), an accountancy firm, its GDP was sixth highest—ahead of several national economies, including Sweden's and Switzerland's. Southern regions outside the capital have gained from its dynamism. For example, Reading, in the heart of the Thames Valley to the west of London, boasts the highest income per person among the 55 biggest towns outside London. The local economy is buoyed by a thriving IT sector including the British headquarters of Microsoft and Oracle; it has also attracted big financial companies such as Prudential and ING. “Overseas, people assume that the Thames Valley is London,” argues Christina Howell of the local chamber of commerce.

The south has also gained in wealth through its booming housing market. Over the past decade house prices have risen most in the south-west and London (after Northern Ireland, a special case thanks to the return of peace) and least in Scotland. International money and big City bonuses have pushed up property prices in choice areas of the capital to the highest in the world, according to a recent study by Knight Frank, an estate agency. The golden touch of City chequebooks has extended far beyond London, causing, for example, astonishing rises in the cost of holiday homes in favoured resorts on the coast of Cornwall in the south-west.

When Mr Blair pulled off an historic third-term victory in 2005, southern voters were grumpier: there was an unexpectedly sharp swing against Labour in constituencies around the capital. One reason was the deteriorating quality of life for many people caused by traffic congestion and overcrowding on commuter trains. A second was that public services in the south face greater strains than in the rest of Britain because public payscales are in the main set nationally, and London's higher cost of living makes it hard to attract staff.

The third and most important reason for their discontent was that the early years of this century were not so good for the London economy: the City was hit by the downturn in international finance after the dotcom crash. Research by John Hawksworth, an economist at PWC, has unveiled a stark difference in performance between the second half of the 1990s and the first half of the current decade. Over the ten years to 2005, disposable incomes grew fastest in London. But that was because the capital did so well in the late 1990s; between 2000 and 2005 income growth in London trailed a bit behind the national average.

These figures do not include the effects of the City's boom in the past couple of years. But they suggest that there may be another political backlash if London now suffers as the economic brakes are slammed on. Since the capital's economy has generally outpaced GDP growth over the past decade, the slowdown to 1.4% that CEBR is forecasting for it next year—in line with the economy as a whole—will be especially painful. Even when London was outstripped by the rest of Britain in 2001, it still managed to expand by 2.0%.

Furthermore house buyers in and around the capital will be pummelled by rising mortgage costs arising

from the credit crunch, a blow that will hit them hard since housing costs already gobble up a bigger share of their household budgets than in the rest of the country. And they can expect no consolation prize in terms of housing-market gains, since house-price growth will slow to zero both nationally and in the south by this time next year, according to Fionnuala Earley, an economist at the Nationwide Building Society.

## The ripple effect

London may have outstripped the rest of the country in the past decade but this has not been at the latter's expense. Rather, the capital's economic vigour has boosted growth elsewhere in a number of ways. For one thing, there is extensive trade between London and the regions. About half of it is in business and financial services. In 2003 London sold £66 billion of such services to the regions but also bought some £42 billion of them, according to a recent report by the Centre for Cities, a think-tank. Trade links are strongest with the south-east, but they are significant with other regions especially the Midlands.

Provincial Britain also benefits as the capital's high rents and labour costs push routine activities out into less expensive locations. This is happening all the time, points out Ian Gordon, professor of human geography at the London School of Economics (LSE): “Given London's high costs, firms are constantly looking for ways to move work out to places where it can be done more cheaply.”

Many of the moves are to the south-east, but firms also move farther afield such as to the north-west of England. “If you don't need to do operations in London, why would you?” asks Ivan Royle of Bank of New York Mellon, which opened a big office in Manchester two years ago. Expanding in Canary Wharf, where the bank has its main operation in Britain, would have meant higher rents, pricier services and a tighter market for talent. Manchester's cheaper costs and big pool of graduates (its university is Britain's largest) clinched the deal. Nor are these all “back office” jobs: the bank's 750-strong Manchester staff includes postgraduates.

Jobs in finance now loom larger in the economies of nearly all big towns than they did a decade ago, especially those that have direct transport links to London. The shift is devoutly sought by local leaders anxious to emulate the capital's winning economic formula. “Regional city bosses have adopted a London-lite strategy,” explains Tony Travers, a local-government guru at the LSE. They, too, want to fire up their economies by attracting jobs in financial and business services and by encouraging knowledge-intensive activities linked to local universities.

One worry is that the best and the brightest still seem to be lured to the capital. A recent study based on the 2001 census showed that the flow of professionals and managers to London from Britain's 26 next largest cities was considerably more than the traffic in the opposite direction. Indeed, the capital's share of recent graduates seems to be rising. Ms Howell of the Thames Valley Chamber of Commerce explains that a stint with a London firm is seen as the best start to a career in many occupations such as law and banking.

On the other hand, London still spins out many more people to the rest of the country than it attracts in domestic migration. Some of these are retirees, but moves, often to the countryside rather than cities, are also triggered when people start families and need more space and better public services. Those who leave have acquired knowledge and experience during their stay in the capital, which “creates a hugely beneficial skill transfer from London to the rest of the country,” says Douglas McWilliams, the head of CEBR.

These migration patterns are closely tied to the housing market, which also helps to spread prosperity across the country. Typically a boom in the capital's economy pushes up local house prices. This prompts Londoners to move out of the capital with bulging wallets, which in turn pushes up house prices in the rest of Britain. This pass-the-baton pattern has been repeated over the past decade.

Newspapers are full of financial woes these days, and there are doubtless more to come. But despite the gloom of the moment, history suggests that the overall economy and the City will both bounce back. London has been buffeted before in its post-war resurgence as an international financial centre. In the mid-1970s, for example, there was a serious banking crisis. In the early 1990s banks made big losses and midway through the decade Barings, a centuries-old bank once dubbed the sixth great power of Europe, collapsed.

## Put out more flags

The City's capacity to roll with such punches and then regain the upper hand suggests not only that it is in the fortunate position of operating in a buoyant sector—as international finance expands in response to globalisation—but also that it enjoys some prized natural advantages. Global financial businesses tend to throng together in just a few cities where they can be sure of drawing upon a big and highly skilled specialist workforce. Once a leading financial centre is established—and the City has had centuries of experience—its position tends to be self-reinforcing, since businesses and talent are attracted to the cluster like bees to pollen.

There is a more specific reason why London's economy may prove resilient this time: the impact of the £9 billion that is being spent on preparations to host the Olympic games in 2012. The building work for the games, spread over the next few years, will help to offset the likely curtailment of some commercial-property developments elsewhere in the capital. This specific boost to the metropolitan economy will come at a time when northern regions, which have especially benefited from Labour's big-spender ways, will be feeling the pinch as public budgets tighten.

The longer-term outlook for London remains bright, according to PWC, whose study projects that it will become the world's fourth biggest city economy by 2020, driven in particular by strong growth in business and financial services. That will be welcome to politicians who have found that the capital's clout enables them to punch beyond Britain's weight. “The City's lustre has burnished Labour's image,” says Mr Travers. But others will worry about the capital's increasing dominance. It has come to seem, for many people, a sort of laboratory in which a rawer, less-cohesive Britain is emerging; a crowded, hustling place of vaulting earnings for the rich and of widening income disparities, which drains talent and wealth from the rest of the country.

Despite these fears, those who cheer as the City falters, will be wrong. The gains from London's position as a global financial hub, a source of envy to other countries, outweigh the losses. Every economy needs an engine-room: better one manned by bankers than none at all.

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Foreign policy and the presidential race

# The world in their hands

Nov 29th 2007 | WASHINGTON, DC
From The Economist print edition

Illustration by Kevin Kallaugher

## How the candidates would handle the rest of the world

"WHO among us understands what to do about Pakistan?" Joe Biden asks a good question. No plausible contender for the presidency has much foreign-policy experience. On the Democratic side, Mr Biden himself, who heads the Senate Foreign Relations Committee, and Bill Richardson, a former ambassador to the United Nations, are both experts. But neither will win the nomination. Among Republicans, Senator John McCain has lots of experience but poor prospects. The front-runners are less solidly prepared. Yet as the news from Baghdad, Beirut, Karachi and Annapolis often reminds voters, the next president will have no time to learn on the job. And the voters care: the Iraq war and security issues generally top their list of concerns.

Of the first-tier candidates, Hillary Clinton probably knows the most about foreign affairs. Name a country or a crisis and she can shoot back with a carefully formulated position on it. But her experience of grappling with foreign powers is slighter than she often implies. Racking up airmiles as first lady is not quite the same as negotiating a treaty. She makes much of her speech to the UN women's conference in Beijing in 1995, but a president has to grapple with tougher problems than that.

Mrs Clinton's foreign policies are mostly dull but sensible. She says America "must be guided by a preference for multilateralism, with unilateralism as an option when absolutely necessary". She thinks international institutions such as the UN are "tools rather than traps". She favours carrots and sticks to cajole Iran and North Korea into abandoning their nuclear ambitions. She says she will not hesitate to use force when America's vital national interests are threatened. Her critics call this cautious and unimaginative. Many of her supporters think that is a good thing—America is tired of recklessness abroad.

Of the other leading Democrats, Barack Obama has probably thought the hardest about foreign policy. When replying to questions, he tries to answer them, rather than simply shooting out scripted sound-bites. He says he will talk directly to America's enemies, a promise Mrs Clinton calls naive. Noting that he grew up partly in Indonesia, he claims a better understanding of foreign cultures than his rivals have. Mrs Clinton scoffs at the idea that four years abroad as a child counts as foreign-policy experience. Mr Obama retorts (with some justification) that he showed better judgment than her in predicting the debacle in Iraq even as she was voting to authorise it.

Among the leading Republicans, Rudy Giuliani is the anti-Hillary. Like five other candidates, he wrote an essay for *Foreign Affairs* about his foreign policies. Whereas Mrs Clinton's is soporific, Mr Giuliani's makes the reader sit up and gasp. "We are all members of the 9/11 generation," says the man who led New

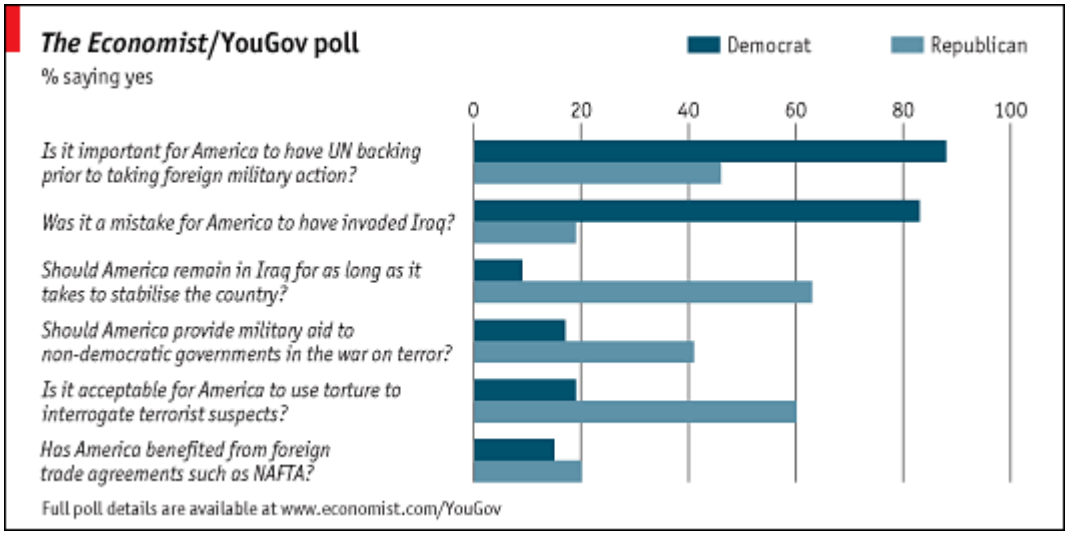
York when the twin towers fell. “Civilisation itself” is under attack. A president's first task is to defend it against “radical Islamic fascism”. America can win in Iraq, he reckons, as it would have won in Vietnam had the politicians not lost their nerve. If you feel that George Bush has been spineless overseas, Mr Giuliani is undoubtedly your man.

Mitt Romney, who leads the Republican race in Iowa and New Hampshire, sounds less confrontational. His habit of listening to both sides of every argument, say his supporters, bodes well. He wants to re-organise the agencies that conduct foreign policy just as he once re-organised private firms, to make them leaner and more focused on specific goals. He sees radical Islam as a grave threat. His response would be to boost the military budget, and to forge a partnership with moderate Muslim states to promote non-radical schools, microcredit, the rule of law, basic health care and human rights in the Muslim world. When campaigning, however, he sometimes resorts to less technocratic sound-bites. His promise during a debate to “double Guantánamo” alarmed civil libertarians.

Of all the candidates, Mr McCain has staked out the clearest principles and stuck to them most doggedly. He stoutly defends free trade to protectionist audiences. He loudly opposes torture while his Republican colleagues prevaricate. He called for extra American troops in Iraq before it was fashionable, and warns war-weary listeners of the terrible consequences of premature withdrawal. The senator's bluntness wins him many admirers, but other things, such as his age, are against him.

## A world of trouble

On the big foreign challenges likely to face a new president, Democrats and Republicans offer contrasting approaches. All the Democrats want to end the war in Iraq, but know it will not be simple. Pressed, neither Mrs Clinton nor Mr Obama nor John Edwards will commit to removing all American troops by 2013. But clearly Democrats would try harder than Republicans to bring more troops home faster. Mr Obama says he would pull out all but those who protect American diplomats and civilians or fight terrorists, and he opposes any permanent American military bases in Iraq. Mrs Clinton also opposes permanent bases, but says a residual American force may have to linger, perhaps based in the Kurdish region.




The Republican candidates say America must win in Iraq before it withdraws. Mr Giuliani, Mr Romney and Mr McCain all cite the recent fall in violence there as evidence that the “surge” of American troops is working. But they disagree as to how to seize this opportunity to help Iraqis build a stable democracy. Mr Romney wants to press neighbouring Arab regimes to help. Mr McCain doubts that Iran or Syria can be persuaded. Mr Giuliani has less to say about nation-building.

Both Democrats and Republicans are alarmed at Iran's apparent plan to build nuclear weapons. But their emphasis is different. Mrs Clinton, Mr Obama and Mr Edwards all refuse to rule out the use of force against Iran. But all stress diplomacy and sanctions to dissuade it from bomb-building, and caution against a rush to war. After Mrs Clinton voted to label as terrorists Iran's Revolutionary Guards, her rivals accused her of smoothing Mr Bush's path to start another war. Republicans are more hawkish. Mr Giuliani will not rule out the use of nuclear weapons against Iranian nuclear sites. Mr Romney favours sanctions so tight that Iranian leaders would start to feel like those who upheld apartheid in South Africa.

Concerning Pakistan, all the candidates deplore General Pervez Musharraf's declaration of martial law. But the Republicans tend to take a softer line on what to do about it, since Pakistan is an ally against al-Qaeda.

Overall, the two parties have much in common. Neither will put much pressure on Israel, nor move as fast to curb global warming as Europeans demand. Most candidates of both parties want to increase the size of the armed forces. But their differences do matter. The Democrats are more protectionist, though Mrs Clinton's promise of “a little time-out” on trade deals commits her to little. The Republicans are more comfortable with using force, and likely to stay longer in Iraq. And Mr Giuliani is far more bellicose than any other candidate. But as to competence, that depends on the individual candidate—and, since none of the leaders has much of a foreign-affairs record, voters will have to guess about that.

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The campaign trail

# Primary colour

Nov 29th 2007
From The Economist print edition

**Zen and the art of politics**
"I drive the Republicans crazy because they've spent hundreds of millions of dollars attacking and defaming me...if that's how they want to spend their time and their money, let them do it. Ultimately, I trust the American people."

*Hillary Clinton has become blasé about the vast right-wing conspiracy. ChicagoTribune.com, November 25th*

**Clash of the titans (1)**
"I think Oprah Winfrey is a remarkable figure. I think she brings not just a celebrity status, but there are millions of people who trust her judgment. I think it's a significant asset to [Barack Obama] and he's not married to her."

*Newt Gingrich, impressed that Ms Winfrey will campaign for Mr Obama. ABC, November 27th*

**Clash of the titans (2)**
"I'm not sure who watches her. Maybe young moms, maybe people who are retired. But we have the support of most retired Democrats."

*Tom Vilsack, a Clinton supporter and former Iowa governor, is not so impressed. WashingtonTimes.com, November 24th*

**Throwing stones**
"He was coming from an entirely glass house."

*Mitt Romney responds to Rudy Giuliani's attacks on his appointments.* Los Angeles Times*, November 26th*

**Christmas wishes**
"Right now, her biggest worry is that Santa may not find her here. She's a little concerned that reindeer can't land anywhere."

*Chris Dodd's six-year-old daughter has concerns about their temporary move to Iowa. Associated Press, November 26th*

**Luvvie endorsement**
"Madame President of the United States...it's an extraordinary thought. We truly are in a momentous time, where a woman's potential has no limitations."

*Barbra Streisand endorses Hillary Clinton. Associated Press, November 27th*

**Leading by example**
"I think in order to leave the best possible example for our kids, we're probably wisest not to talk about our own indiscretions in great detail."

*Mitt Romney responds to Barack Obama's admissions of drug use. CNN.com, November 24th*

**The over-educated voter**
"One of the great pleasures of running for president has been, you know, to go to some tiny town in Iowa and you've got some guy in overalls and a seed hat say, 'What do you think about the situation in Burma?' You know, and you think he is going to ask you about corn, and he asks you about Burma."

*Barack Obama discusses the average Iowan. ABCNews.com, November 27th*

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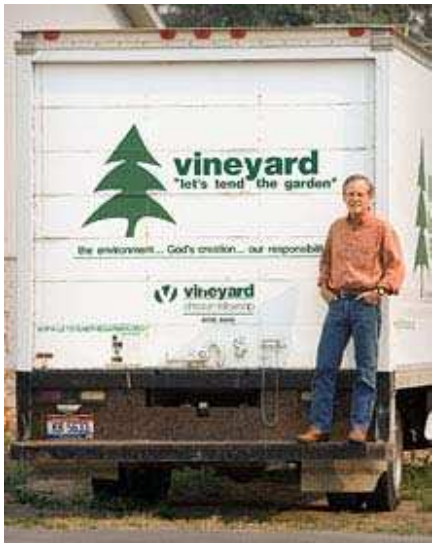
Religion and the environment

# A cross of green

Nov 29th 2007 | AUSTIN
From The Economist print edition

## The continuing rise of creation care

AP




Get article background

AS AMERICAN officials fly off to Bali for a meeting on climate change, they will be thinking hard about the people back home who are studying their every move. In contrast to 1997, when the religious right led denunciations of the deal negotiated in Kyoto, many of today's evangelicals want America to be generous and constructive.

“Regardless of whether all nations agree to be part of the solution, America must do the right thing.” That was an amazing statement, when it was first made in 2006 as part of a green manifesto issued by a group of religious activists led by Richard Cizik, vice-president of the National Association of Evangelicals. But Mr Cizik has gone a long way towards transforming the thinking of American Christians about the planet. It helps that he is no liberal softie: he still opposes abortion, same-sex marriage and stem-cell research.

Even so, Mr Cizik and other green evangelicals have faced an uphill battle. Their preference for the term “creation care” is a reflection, in part, of the horror that the word “environmentalism”—tinged with secular humanism, even liberal paganism—still strikes in the evangelical psyche.

The late Jerry Falwell, for example, loathed environmentalists. In March he said global warming was “Satan's attempt” to distract the church from its fight against abortion and gay marriage. Since his death, the anti-environmental torch has been carried by leading evangelicals like James Dobson and Gary Bauer. But as the creation-care movement picks up, they are starting to sound like dinosaurs. According to a poll in October, two-thirds of evangelicals want immediate action on global warming. Creation care is only part of it: the urge to enhance national security by lessening America's dependence on foreign oil is important too.

The new mood reflects a generational change among evangelicals, says Andrew Walsh, a religion-watcher at Trinity College, Hartford. The younger lot wants to focus more on issues such as AIDS and the crisis in Darfur—a cluster of concerns that have more in common with climate change than with crusading against homosexuality. Among many of the new generation there is less of a feeling that America must always pursue its own interests, adds Dennis Hoover, a writer on conservative Protestantism.

One open question is how far green evangelicals can go in co-operating with Christians with a different ethos. At least in his early green days, Mr Cizik avoided associating with mainline Protestants who were liberal in politics as well as theology. But some intriguing exchanges may be triggered by the recent conversion of Pope Benedict XVI—widely admired by American conservatives—to the view that global warming is a serious issue.

Already, even within the evangelical camp, some patching over of differences has been needed to rally round the green cause: some eco-evangelicals root their beliefs in a literal reading of the book of Genesis, while others interpret the Creation story a bit more freely. The theology is going to get more and more interesting.

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Animal health

# From stockyards to animal health

Nov 29th 2007 | KANSAS CITY, MISSOURI
From The Economist print edition

**Kansas sets out to be the industry hub**

THE ambition, in Kansas City at least, is to make the “Animal Health Corridor” as recognisable to everyone as, say, Silicon Valley. The hope was born last year, with the publication of a study by Ron Brakke, a Dallas-based animal-health consultant. Mr Brakke found that the region houses more than 120 companies serving the animal-health and nutrition industries, including four of the ten largest international manufacturers of animal-health products. Businesses based in the region account for 27% of the $5 billion national animal-health market and 32% of the $15 billion worldwide market.

These numbers have been the basis of a busy branding campaign by Kansas City. The effort began with the official designation of the corridor and a $300,000 donation from Joerg Ohle, the president of the animal-health division of Bayer HealthCare, which has its headquarters in a local suburb. The University of Kansas will soon begin offering a master's degree in business administration for animal-health students. The Kansas City Life Sciences Institute is offering $50,000 grants to universities that undertake research of interest to local companies. And the state of Missouri has adopted its own veterinary-student loan programme.

The branding campaign has gone quite well, so far. The US Animal Health Association has been enticed to Kansas from Virginia. IdentiGEN, a Dublin-based food-safety company, has relocated its American headquarters. And MWI Veterinary Supply, one of the largest animal-health distributors in the country, is moving its Midwest distribution centre to Kansas. Kansas State University, on the western edge of the corridor, is among five sites being considered for the National Bio and Agro-Defence Facility. This $450m venture will replace the Plum Island Animal Disease Centre in Greenport, New York, in the research of diseases that can be transmitted to humans from animals.

Kansas is trading on its “cow town” heritage. The Kansas City Stock Yards opened in the late 1800s and quickly became one of the busiest in the country. Built in 1910, the Kansas City Livestock Exchange was the largest building in the world devoted solely to livestock. Nowadays, according to the Brakke report, more than 45% of the country's feedlot-raised cattle and 40% of its hogs are to be found within 350 miles of Kansas City.

The stockyards attracted the support of industries including the animal food and medicine businesses. Today the region is equipped with specialised lending institutions, advertising agencies, and legal and accounting firms. Location counts for a lot, as always. So maybe Silicon Valley will indeed get its bovine equivalent.

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**Californian casinos**

# The new Indian wars

Nov 29th 2007 | SAN DIEGO
From The Economist print edition

AP

**Playing for high stakes**

**A fight is brewing over booming Indian gambling**

APART from a few pots and baskets sitting, largely unnoticed, in a corner, there is little distinctively Indian about the Sycuan Casino. The punters are the usual mix of retirees and the statistically inept. The casino has three floors with some 2,300 jangling slot machines, a few card tables and a 1,250-seat bingo hall. That is not quite enough to meet demand, which is why the Sycuan tribe wants to expand. Whether it is allowed to do so will depend on how California's voters feel about the enormous casinos that have sprouted in their midst. It will also be a test of their views of Indians.

Indian tribes are free to run casinos because, as sovereign nations, they are not subject to all state laws. Yet the tribes must agree terms with the state. Last year the Sycuan, together with four other tribes, negotiated agreements with Arnold Schwarzenegger, California's governor, that would allow them greatly to enlarge their casinos in exchange for paying more taxes. A motley crew of gambling opponents, racetrack owners, unions and rival tribes objected. As a result, a judge ruled this week, the agreements must be ratified by the state's voters in February. The television advertising blitz has already begun.

Opponents claim that the new agreements provide an unfair advantage and will allow already large casinos to dominate the market. Al Lundeen of No on the Unfair Gambling Deals (the chief opposition group) points out that an earlier round of agreements imposed a fee for each new slot machine above a certain level. The new deals, on the other hand, impose a percentage tax on the winnings from extra machines. That creates a different incentive. Tribes with the first kind of deal are inclined to grow cautiously, because slot machines that remain idle lose money. Tribes with the second kind of deal can shoehorn in the video-poker terminals and wait for demand to catch up with supply.

The outcome of the vote will not just affect the tribes. Alan Meister, an economist, reckons California's Indian tribes paid $308m directly to state and local coffers last year, with much more expected if the biggest operations are allowed to grow. That will come in handy for balancing the state's perennially shaky budgets. The impact can be even greater locally. In San Diego county, where no fewer than 10 tribes run casinos, they supply much-needed jobs and services. The Sycuan's 25-man fire crew spends much of its time dealing with emergencies outside the tiny reservation.

Mark DiCamillo, a pollster, foresees a brutal fight. At present the agreements are supported by 52% of voters, with 35% opposed. But that is hardly a comfortable lead at this stage in the campaign. Experience suggests it is much easier to turn people against a reform than to rally them behind it. And

several polls, including Mr DiCamillo's, find voters evenly divided on whether allowing Indian casinos to grow is a good thing in principle.

To Daniel Tucker, the Sycuan's chairman, the issue turns on politics and history. The tribe's past was grim, even by American Indian standards, so it must be allowed to determine its own future. So far California's voters have treated Indian casinos as a special case, twice approving them while crushing attempts to expand gambling elsewhere. But given the slick money-making operations that have emerged on the reservations, will they do so again?

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**Construction on campus**

# Just add cash

Nov 29th 2007 | BOSTON, PHILADELPHIA AND STORRS, CONNECTICUT
From The Economist print edition

Reuters

**Boston's gleaming spire**

**The great expanding American university**

STAND next to the bronze statue of Benjamin Franklin on the University of Pennsylvania's College Green at midday and along with the chirps of grey squirrels you will probably hear the squeal of buzz saws. Penn is erecting a new building for its Annenberg Public Policy Centre just off Franklin's grassy quadrangle. Over the next decade the university will also tear up around 50 acres (20 hectares) of land adjacent to its campus, replacing industrial asphalt with sports fields and mixed-use, glass-and-steel high-rises. The university's planners are ambitious, even extending to the construction of a new bridge over the Schuylkill river to connect it all better to downtown Philadelphia.

This dynamism, lubricated with easy access to capital, is hardly unusual on America's gleaming campuses. Take two spectacular examples, both of which are reshaping metropolitan Boston. The Massachusetts Institute of Technology (MIT) has already added many acres of new laboratory and study space in a $1 billion expansion programme, including its curvy, $300m Stata Centre, pictured above. And over the next 50 years Harvard University is going to construct a brand new campus on a 200-acre swathe of Boston it conveniently owns.

State-funded institutions are also splashing out. Deval Patrick, the governor of Massachusetts, wants to use $2 billion for capital improvements to his state's public universities. The state of Connecticut's flagship campus has already added or renovated 9.2m square feet (850,000 square metres). The university has also teamed up with regional officials to construct a brand-new “college town” of dense commercial and residential properties (a mock-up includes Parisian pavement cafés) in the otherwise rural north-east of the state.

In its annual survey, *College Planning & Management*, a trade magazine, calculates that America's colleges and universities completed $15 billion worth of building in 2006—an astonishing 260% increase since 1997—and will start projects costing about the same amount this year. The study's author adds that these figures probably understate the amount universities are spending because of gaps in reporting. Many campuses are investing in laboratories, better student housing and recreational space. But with university fees already exorbitant, how can America's universities justify their building binge?

## If you build it...

Part of the explanation is demographic. The Department of Education estimates that American high schools pumped out 3,176,000 seniors in 2006, up 26% from 1995. Consequently, university enrolments

swelled 24% during the same period and are projected to rise another 13% by 2015. Naturally, the universities need places to house and teach all these new students. According to the National Science Foundation, American academic institutions began constructing 10.2m square feet of new scientific research space in 2004-05

But with more students entering university, there are also more desirable applicants, a fact that encourages universities to try and expand the number of highly qualified students they can attract. New student amenities and labs help universities outdo each other. The competition for prestige, in the form of top students, prominent faculty members and grant money, is intense: it can also get remarkably petty. Last year the *Dallas Morning News* reported that Baylor University increased the height of its planned rock-climbing wall from 41 to 52 feet after learning that Texas A&M University's was 44 feet. Then the University of Houston built a climbing wall that was 53 feet high, and even that was later surpassed by the University of Texas at San Antonio.

New and better lab space, meanwhile, can draw star scientists, research-grant money and revenue from patents that result from that research. All of that—along with, preferably, a new stem-cell lab that can be used in promotional tours—in turn attracts more top applicants. Dramatically increased National Institutes of Health (NIH) funding over the last 15 years has been a fat carrot dangling before universities, encouraging them to spend frantically on new labs in order to win high-profile federal projects.

In 2006 a Standard & Poor's report described the university construction boom as an “arms race”—implying that it was expensive and ultimately tangential to their educational mission. Indeed, Daniel Greenberg, a Washington journalist, has argued that universities are overbuilding, and are ending up with underused lab space as the NIH budget flattens out.

Meanwhile, according to the Department of Education, the average annual cost of a standard four-year course at an American university has trebled since the 1985-86 school year. Ohio University increased its tuition fees by 2% to pay for its student centre, which contains a 250-seat theatre, a food court and a five-storey atrium. In addition, universities are increasingly being forced to rely on debt.

The emphasis on new science space also neglects politics or humanities students. Even many undergraduates studying science will have limited access to the benefits of the new campus labs, which are there mostly for the benefit of faculty members and their graduate students. Hiring more teaching staff and cutting class sizes would probably be of more help to undergraduates than much of the new construction. Universities such as Harvard may have the money available to improve their faculty to student ratio, allocate cash for assisting poorer students and go on competing in the building frenzy. But others do not have that luxury.

Nevertheless, administrators bristle at the arms-race metaphor, with its inherent accusation of wastefulness. Amy Gutmann, Penn's president, argues that in the long term the market will reward universities that invest in their facilities. Besides, Penn's planned improvements to its medical centre and its new sports fields will serve the community, and its nanotechnology centre will be open to undergraduates as well as faculty members.

By investing in the state university system, Connecticut hopes to keep talented residents in the state and to buoy its prospects in the growing knowledge economy. And MIT has helped establish a wildly successful private biotechnology corridor in and around its campus, which is already pioneering a new generation of life-saving innovations. Rafael Reif, MIT's provost, says that the university's expansion is largely demand-driven: students and professors, he claims, both see the mixture of biology and engineering as the basis for future waves of technological advancement.

To some extent, better student housing is simply a reflection of higher living standards across the country. Roger Brown, president of the Berklee College of Music, thinks new dormitories will better anchor his students in Boston's Back Bay neighbourhood; he hopes they will contribute to the area's cultural life. The opportunity cost of new building is more justifiable when students get adequate financial support, as they do at Penn, Ms Gutmann argues.

Many of the new buildings will be tangential to most students' academic lives. But better faculty members, more research and more money to pay for both have enabled America's leading universities to build the most vibrant system of higher education in the world. They will need to maintain that vigour if the country is to preserve its lead in services and technological innovation. As so often in America, competition has produced success—and a certain amount of excess.

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Lexington

# Obama's moment

Nov 29th 2007
From The Economist print edition

Illustration by Kevin Kallaugher

**At last, a real fight for the Democratic nomination**

BARACK OBAMA has been a frustrating presidential candidate, a strange mixture of promise and disappointment. There is the promise of the rhetorical firepower that he put on display so memorably at the 2004 Democratic convention. There is the promise of his Kennedyesque idealism. And there is the promise of his unique background: a black candidate in a country that was once run by slave-owners; a world citizen in a country that has gloried too much in its exceptionalism; a half-Kenyan, half-Kansan who went to school in Jakarta.

Yet his performance has often been disappointing. He can be languid and long-winded. During debates he often starts with a bang only to end with a whimper. He is too fond of vaporous abstractions. He sometimes looks more like the junior professor he once was than a political heavyweight, and his policies are sometimes half-baked, as when he contemplated sending troops into Pakistan, a sovereign state, and a particularly fragile one, to kill or capture al-Qaeda chieftains.

Can Mr Obama recapture his early promise? And can he translate it into a victory in the primaries? Two months ago it looked impossible. Today, with just a month to go until the Iowa caucuses, he is on a roll. He delivered one of the best speeches of his career at the annual Jefferson Jackson dinner there. And his campaign has been reinvigorated by a recent poll that put him four points ahead of Hillary Clinton.

Four points is small potatoes. It is within the margin of error and Iowa polls can be especially unreliable because the turnout for caucuses is so low. But the good news is not confined to four stray points. Thirty-four percent of likely caucus-goers ranked him as their second choice, more than twice as many as for Mrs Clinton. Under Iowa Democrats' complicated rules you get to vote again if your first-choice candidate fails to clear a 15% hurdle, so Mr Obama may stand to pick up a good number of additional votes. A few recent polls have shown him doing better than Mrs Clinton in head-to-head races against the main Republican candidates, and a Zogby poll this week showed her losing to all leading Republicans, but him winning.

The Obamaites are walking with a spring in their step—and will soon have Oprah Winfrey walking alongside them. The Clintonites are pouring resources into Iowa while lowering expectations. One or other of the Clintons will be in Iowa every day bar Christmas until the vote on January 3rd. One campaign spokesman says that “our definition of success doesn't necessarily mean coming in first.”

Mr Obama is recapturing the excitement that made his campaign such a spectacle of cheering crowds

and kerchinging coffers. He is also reminding people why they have reservations about Mrs Clinton—not least her habit of wrapping a sense of entitlement in a feminist garment. Mrs Clinton has been at pains to emphasise that she has much more experience than her rival. She has wondered whether “living in a foreign country at the age of ten prepares one to face the big, complex international challenges the next president will face”. But Mr Obama has pointedly noted that “my understanding is that she wasn't treasury secretary in the Clinton administration. I don't know exactly what experience she's claiming.”

## Evitable

And Mr Obama is beginning to offer something that has eluded him so far—the sense that he just might win. The case for Mrs Clinton has always rested heavily on a combination of inevitability and electability. People will vote for her not because they love her—her crowds are notably less enthusiastic than Mr Obama's—but because they calculate that other people will vote for her. An Obama victory in Iowa might just persuade Democrats to take another look. Mr Obama, who is by far the most popular Democrat among Republicans, is probably the best placed candidate to turn a good Democratic year into a landslide; he is certainly better placed than Mrs Clinton, whose unpopularity with what she called “the vast right-wing conspiracy” will breathe new life into the moribund Republican body.

This belated surge will be enough to guarantee a real fight in Iowa. But will it be enough to create a new electoral dynamic? Some of the recent Obamamania can be discounted—the polls always tighten in the run up to a vote. Mrs Clinton preserves her earlier advantages: her huge lead in the national polls, her formidable competence as a debater, her relentless energy.

Mr Obama finds himself in much the same position as John McCain in 2000: everything needs to go right for him. He not only needs to win in Iowa; he needs to translate that into enough momentum to carry him through New Hampshire, South Carolina and on into “mega-Tuesday”, on February 5th. But Mrs Clinton is surrounded by firewalls and Obamatraps. If she wins in Iowa, she might have the nomination in the bag; if she loses, she might recover in New Hampshire or South Carolina, or stage a rally on mega-Tuesday.

Mr Obama is also coming in for closer scrutiny. He may have bested Mrs Clinton with his Treasury one-liner. But he is notably light on experience, particularly of foreign policy, where he can seem vacuous compared with Mrs Clinton. The former advocate of merit pay for teachers now waffles about support for a “system designed with the help and agreement of teachers' organisations”; his opposition to NAFTA is mere crowd-pleasing.

There is no doubt that Mr Obama and his surrogates have succeeded in raising doubts about Mrs Clinton. But he still has to prove he is made of presidential stuff. He must show he is willing to take on Democratic interest groups. And he needs to prove that he has the animal appetite to out-campaign his rival in the frost and snow of Iowa and New Hampshire. Otherwise Mrs Clinton's giant snowplough will ride right over him.

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# Correction: Mike Huckabee

Nov 29th 2007
From The Economist print edition

Last week we said that the Fair Tax plan endorsed by Mike Huckabee would involve rebates “to those who need them”. In fact, they would go to all families whose spending is below the federal poverty level. Sorry.

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Venezuela

# Are they beginning to lose the faith?

Nov 29th 2007 | CARACAS
From The Economist print edition

Lindsey Ross

**Hugo Chávez's attempt to turn his country into a socialist utopia under personal direction is running into trouble**

SOME of the proposed articles are “not good”, he admits, though he is vague about the details. But Freddy Medina has no doubt about which way he will vote in December 2nd's referendum on constitutional reform. “I will support my president,” he says. What makes this loyalty to Hugo Chávez remarkable is that Mr Medina, a building worker, is about to be evicted from the three-room home he has spent the past two decades building on a steep hillside in La Pedrera, in the poor suburbs of south-western Caracas, the capital. Years of leaks from poorly maintained water and sewerage systems, combined with recent rains, have triggered landslides that have wrecked several of his neighbours' homes and left his vulnerable. The government has promised to rehouse him, but has not yet done so.

Thanks to the devotion of people like Mr Medina, Mr Chávez has easily won ten national ballots—including two presidential elections and several referendums—since he first arrived in office in 1999. Only last December he won a new six-year term with 63% of the vote. He has showered record oil revenues on social programmes for the poor while gradually turning a liberal democracy into a more authoritarian and less plural regime. But now, in trying to push through the radical rewriting of a constitution that he himself fathered in 1999, he may have gone a step too far.

Mr Chávez's reform proposes radical changes to 69 of the constitution's 350 articles. They put into effect his campaign promise to implement “21st-Century Socialism”. On the one hand, the economy is officially declared to be based on “socialist, anti-imperialist [and] humanist principles”, with protection of private property weakened. On the other, yet more power would be centralised in the presidency.

Mr Chávez would have full control over the Central Bank and its reserves. Elected local government would be undermined: the president would have untrammelled power to appoint the governor of Caracas, to create new federal territories, and to set up and finance a national “Popular Power” based on unelected communal councils. The new draft also weakens some of the “participatory” clauses of the 1999 constitution, raising from 10% to 30% the proportion of voters required to petition for a referendum. And it would abolish presidential term limits, allowing Mr Chávez to run again indefinitely.

Officials claim that the reform will deepen a popular revolution and give Venezuelans more rights. They point to clauses offering a free education, a cut in the working day from eight to six hours, and the extension of social security to informal workers. The government has not revealed the cost of such measures, none of which requires constitutional change.

Opponents see the reform as a big step away from democracy and towards a totalitarian state along Cuban lines. The novelty is that so, too, do some of Mr Chávez's erstwhile supporters. The reform is opening up what may be a lasting fissure in the *chavista* camp, driving those who see themselves as democratic socialists towards the opposition.

“Many of the articles there flout the essence of democracy,” says Ismael García, leader of Podemos, one of four parties that have formed the governing coalition since 1998 but which has now joined the “No” campaign in the referendum.

Another weighty opponent is General Raul Baduel, who was defence minister until July and whose role in restoring Mr Chávez to the presidential palace after an abortive coup in 2002 made him a hero to *chavistas*. The proposed reform amounts to “constitutional fraud” and a “coup d'état”, he says. “Democracies should be very careful that there is a division of powers, with counterbalances. This [the reform] would put democratic institutionality at risk.” For its part, the opposition has been revitalised by the emergence of a powerful student movement, untainted by involvement in the 2002 coup or other failures of the past.

Several pollsters who predicted Mr Chávez's election victory last year reckon that the referendum is now too close to call. They find a majority of respondents oppose the reform, but it is not clear how many of them will actually vote. In one of several signs that Mr Chávez is rattled, the government-dominated electoral authority decided to ban the publication of polls in the last week before the vote.

The president is a formidable campaigner and has honed a powerful political machine that can draw on the state's resources: metro stations and government offices are plastered with posters backing the reform. A study by the electoral authority found that government-linked television channels gave those against the reform only 1% of the total time given to those in favour; the remaining commercial channels favoured the No campaign, but by a much smaller margin.

Mr Chávez points out that many of those now passionately defending the 1999 constitution originally opposed it. He remains popular (with 60% of Venezuelans, the polls suggest). He is striving to turn the referendum into a plebiscite on himself. In a play on words, the placards proclaim “SIgue con Chávez” (roughly, “Yes, let's go on with Chávez”). Many shrewd observers in Caracas reckon that all this means that the president may win, though more narrowly than in the past.

But there are signs that the Chávez magic is starting to fade. Inflation is rising, while three years of price controls mean that basic foods such as milk, eggs and flour are often unobtainable. Violent crime is rampant, especially in poorer areas.

The referendum may be decided by how many Venezuelans bother to vote. Those in the opposition who called for abstention in past elections (claiming that the electoral authority was not impartial) have this time called on their supporters to vote, whereas in the *chavista* camp, there are signs of apathy. How widespread this proves to be may determine whether or not Venezuela remains a democracy.

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Colombia and Venezuela

# Sad pawn sent to freezer

Nov 29th 2007 | BOGOTÁ AND CARACAS
From The Economist print edition

**A jilted mediator unleashes a war of words**

AP

**Mr Betancourt; still hoping, five years on**

THE decision in August by Álvaro Uribe, Colombia's president, to invite his Venezuelan counterpart, Hugo Chávez, to help broker the release of 45 hostages held by FARC guerrillas for the past five years always looked like a misjudgement. It took only three months for Mr Uribe to have second thoughts. But when he told Mr Chávez that he was cancelling his mediation effort, it unleashed volleys of invective between the two leaders.

After a telltale pause that spoke of premeditation rather than spontaneous frustration, Mr Chávez began by calling Mr Uribe a “liar and cynic” who “does not want peace”, adding that Colombia “deserves a better president”. Mr Uribe in turn accused his neighbour of seeking to “build an empire based on his [oil-rich] budget” and of wanting Colombia to be “a victim of a FARC terrorist government”. That prompted Mr Chávez to dub Mr Uribe “a sad pawn of the empire” (as he likes to call the United States), say that he was putting relations with Colombia “in the freezer” and recall his ambassador in Bogotá. He would have “no type of relationship” with Mr Uribe's government, he vowed.

Mr Uribe may reckon that a few insults are a price worth paying for ending a venture that seemed certain to provide political gains for Mr Chávez and the FARC but looked unlikely to free all the hostages—if any. These include Colombian police and army officers, three American contractors and Ingrid Betancourt, a politician of dual Franco-Colombian nationality. Mr Uribe was under pressure both from Colombians and from Nicolas Sarkozy, France's president, to reach a deal with the FARC that would see its captives swapped for rebel prisoners in Colombia's jails. The FARC are known to view the anti-American Mr Chávez with sympathy. But in turning to him, Mr Uribe also seemed to be showing his pique at the refusal by the Democrats who control the United States Congress to ratify a free-trade agreement with Colombia.

Venezuela's president took to the role of mediator with predictable gusto. He met the hostages' families and invited a FARC leader to his presidential palace. He accepted an invitation from Mr Sarkozy to visit Paris. He wanted to arrange a personal meeting with Manuel Marulanda, the FARC' s veteran leader. He spoke to Colombia's army commander without going through Mr Uribe—something which Colombia's president claimed he had been explicitly asked not to do.

Piedad Cordóba, a leftist Colombian senator who was co-mediator, claimed this week that the initiative had made great progress, that the FARC had backed down on some of its demands and that a prisoner swap would lead to full-blown peace talks. To others it didn't look like it: the FARC failed even to provide proof that the hostages were still alive. Mr Chávez himself said he expected the mediation to take a year.

Relations between Colombia and Venezuela have long mixed closeness with tensions, some of them caused by the spillover from Colombia's armed conflict. Though political opposites, the conservative Mr Uribe and the socialist Mr Chávez share a populist, demagogic streak. They had struck up a surprisingly warm relationship of mutual respect. That will not be easily restored. Rodrigo Pardo, a former Colombian foreign minister who now edits *Cambio*, a newsmagazine, said he had never witnessed such harsh exchanges between the two countries' leaders, even when a missile-bearing Colombian warship entered waters claimed by both countries in 1987. But he doubts relations will break down completely.

For both countries, the other is too important to ignore. For each, the other is the second-largest trading partner after the United States. Trade between them totalled $4 billion last year and is heading for $5

billion-$6 billion this year. Venezuela takes many of Colombia's manufactured goods. Thanks partly to the inefficiencies generated by Mr Chávez's populist economic policies, Venezuela depends on Colombia for staples such as milk. It even imports natural gas from its neighbour through a pipeline inaugurated by the two presidents this year.

Mr Chávez faces an unexpectedly close battle to win approval for a constitutional referendum on December 2nd that opponents say would turn Venezuela into a socialist autocracy (see article). Many people in Caracas share Mr Uribe's view that Mr Chávez is exploiting the row between the two of them to stir up nationalist feeling. Colombia has said that its ambassador is staying put in Caracas. Once the referendum is out of the way, expect his Venezuelan counterpart to return to his post in Bogotá.

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Pakistan

# Lest old acquaintance be forgot

Nov 29th 2007 | LAHORE
From The Economist print edition

Reuters

**General Musharraf goes back to Civvy Street. Other civilians are not happy**

Get article background

PERVEZ MUSHARRAF, Pakistan's beleaguered president, who prides himself on being a man of his word, had often promised to stand down as chief of the army. So on November 28th he inspected a guard of honour in Rawalpindi and passed the baton to General Ashfaq Pervez Kayani. Dressed in full regalia and bursting with emotion, General Musharraf said: “This army is my life, my passion. I love this army, and this relationship will continue, although I will not be in uniform.” Aptly, the military band gave him a stirring send-off with “Auld Lang Syne”.

The next day plain “Mr” Musharraf was sworn in as a civilian president of the country by his new handpicked chief justice. His advisers say that President Musharraf will soon lift the state of emergency he imposed on November 3rd. That unconstitutional “deviation”, as it is called in Pakistan, enabled Mr Musharraf to sack 12 judges of the supreme court who seemed bent on overthrowing him. He replaced them with more pliant ones. They have now duly legitimised his presidency.

Even by Pakistani standards, it has been a tumultuous week. Mr Musharraf had long thundered that he would not allow Nawaz Sharif, the former prime minister he ousted in a coup in 1999, to return to Pakistan from exile in Saudi Arabia and rejoin politics. Indeed, when Mr Sharif tried to come home in September, he was bundled into a waiting aircraft at Islamabad and shunted off to Jeddah. But another former prime minister in exile, Benazir Bhutto, was allowed back on October 18th, thanks to American pressure on General Musharraf to make an alliance with her liberal People's Party. Mr Musharraf flew to Riyadh on November 22nd in a bid to convince King Abdullah to hang on to Mr Sharif until after the general elections on January 8th. But, far from entertaining the plea, the monarch dispatched Mr Sharif to Pakistan in a royal aircraft on November 25th, just in time to file his nomination papers for the elections.

The opposition is seized with the difficulty of ensuring free and fair elections, or, failing that, of forging a united front to boycott the polls. Neither task is easy. Mr Musharraf has packed the election commission and caretaker administration with loyalists and rigged the rules.

The opposition, moreover, is divided. Miss Bhutto has gauged her popularity—huge crowds welcomed her on October 18th—and wants to contest an election. But she is using the threat of a boycott to press demands that the state of emergency be lifted, pro-Musharraf local governments suspended, and the

election commission reformed. Maulana Fazal ur Rehman, the leader of the biggest religious party, wants much the same. He hopes to form governments in the North-West Frontier province and Baluchistan.

Only Mr Sharif favours a boycott. But he fears he would be sidelined if he goes it alone. So he is hedging his bets. He has filed his nomination papers but is also hoping for an all-parties conference to agree on a boycott. If, as seems likely, Mr Musharraf meets some opposition demands, the elections will go ahead.

But they may not provide stability to Mr Musharraf's position—let alone Pakistan's. The country is bitterly divided across religious, regional, ethnic and class lines. Coalition governments in Islamabad and in the provinces are inevitable. As in the past, Mr Musharraf's party will be inclined to make alliances with the religious parties. But that will be looked at askance in America, which frets that such expedient political alliances help explain why Mr Musharraf's prosecution of the war against Islamist terrorists is ineffectual.

However, if Mr Musharraf wants a deal with Miss Bhutto, he will have to share power with her, perhaps as prime minister, a prospect neither he nor his party relishes. If he spurns her, she will join hands with Mr Sharif and the mullahs to dethrone him. When Parliament meets in February, he will need a two-thirds majority to legitimise his “deviation” on November 3rd. Failing that, he would risk impeachment and have to turn for help to his new army chief, General Kayani. Pakistan would revert to rule by the “troika” of army chief, president and prime minister, an arrangement that has scarred politics since the restoration of democracy in 1988. One elected government after another has been sacked by the president (thrice) or the army chief (once, in 1999).

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Australia's new leader

# Rudd, glorious Rudd!

Nov 29th 2007 | SYDNEY
From The Economist print edition

AFP

Rudd hears and heeds the call

**Why the Labor leader won a landslide and what he might do now**

THE votes started as a trickle, but soon became a flood. Just a few hours after polling stations closed on November 24th, Kevin Rudd stood before cheering supporters in Brisbane as Australia's new prime minister. It was a remarkable achievement for a man who entered Parliament only in 1998, and who took over the leadership of a demoralised Labor Party less than a year ago. For John Howard, the leader he toppled, the defeat was crushing, humiliating and one for the history books. Not only had he led the conservative Liberal Party to the worst rout in its 63-year history. It seemed certain he would also become only the second serving Australian prime minister to lose his own seat.

With postal votes still being counted, Mr Howard appeared to have written off Bennelong, the Sydney constituency he had held for 33 years, to Labor's Maxine McKew, a former television journalist. The swing of almost 6% against him there was the same as the national swing that delivered Labor at least 80 seats in the 150-seat House of Representatives.

Opinion polls had long predicted just such a result. Even so, Australia's political class was flabbergasted. In power since 1996, Mr Howard had comforted himself with a homespun theory: governments do not lose office if economies are humming smoothly, and if they are free of scandal. The voters proved him wrong.

Mr Howard had presided over a high-employment, low-inflation economy. He also shifted the Liberals further to the right than ever. But, at 68, he failed to read signals, including a few from within his own party, that voters could tolerate only so far his often divisive approach to government. Mr Howard's workplace law, replacing collective bargaining with individual contracts, was a centrepiece of his fourth term. He sold it badly, and allowed Labor to brand it as an ideological attack on union power and workers' rights. Mr Rudd has made its repeal a priority, although he will leave alone contracts already signed.

Labor also made hay from a scandal that broke a few days before the election, in which Liberals in a Sydney suburb were caught distributing bogus pamphlets painting Labor as supporting Islamist terrorism. The affair played to the Liberals' image under Mr Howard as prone to a mean brand of “wedge” politics on social issues. It helped the Liberals lose a constituency they had held for 11 years.

As Mr Rudd took over, he threw out some clues about what Australians may expect from him. At 50, he comes with few, if any, vestiges of an old-fashioned Labor background. The son of a Queensland farmer, who died when he was 11, Mr Rudd went to the same rural state high school as Wayne Swan, who will become his first treasurer (finance minister). He worked as a diplomat and business consultant in China, and is probably the only Western leader to speak fluent Mandarin.

So it was no surprise that he hand-picked his first ministry on November 29th, ditching Labor's tradition that left and right party factions be consulted first. Merit was the test for a modern country, he declared, not “whether you belong to the united union for folding chairs, or whatever”. Equally, Mr Rudd is intending his first overseas trip to Bali in early December, for a United Nations conference on climate change, to send signals about his foreign-policy agenda. He will tell the conference that Australia plans, at last, to ratify the Kyoto protocol. Mr Rudd had made this a central point of difference from the Howard government's subservience to President Bush's refusal to ratify.

The Indonesia visit will also highlight Mr Rudd's talk of pursuing closer economic and humanitarian engagement with Australia's neighbourhood. Soon after that, he will get talks under way with America and Iraq about his pledge to withdraw Australia's 500 combat troops from Iraq (but not a wider military contingent in the Gulf) by mid-2008.

Having been used to an unquestioning ally in Mr Howard, America will not be pleased. But no one should expect anything radical from Mr Rudd on reshaping either the American alliance or almost any other policy field. Hugh White, of the Lowy Institute, a Sydney think-tank, recalls Mr Rudd from his diplomatic days as a realist: “He's always regarded foreign affairs as about the exercise of power.”

While Mr Rudd is in Bali, Julia Gillard, his deputy, will become the first woman to act as Australia's prime minister. Another symbolic step is due early in the first parliamentary term, when Mr Rudd has promised to make a formal apology to indigenous Australians for past injustices. Mr Howard had stubbornly refused to offer such an act of contrition.

A sterner test of the new prime minister's realism is more likely to come from his government's handling of Australia's robust economy. Voters were clearly unimpressed by the Howard government's scare campaign that Labor was inexperienced, a slave to unions and would mess up the miracle. That is understandable: Mr Rudd is in the tradition of market-based reforms that Labor governments introduced in the 1980s and early 1990s, underpinning the boom of the Howard years.

But after raising interest rates during the election campaign, for the sixth time since the last election in 2004, the central bank warned that inflationary pressures were a worry. Mr Rudd must ensure, therefore, that wages and government spending are kept in control. Nonetheless Heather Ridout, chief executive of the Australian Industry Group, a leading business lobby, is confident business can work with Labor. She welcomes Mr Rudd as someone who “understands the pressures on business”.

Meanwhile, the Liberals' outlook is grim. They are now out of power federally and in all states. Peter Costello, Mr Howard's treasurer and anointed successor, said he was no longer interested in leading the party. Instead it installed Brendan Nelson, 49, the former defence minister, who may try to pull the Liberals back towards the political centre. Recriminations in the party over the devastating defeat have probably only just begun.

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The EU-China summit

# The world does not shake China

Nov 29th 2007 | BEIJING
From The Economist print edition

## On trade or the exchange rate

Get article background

"LET China sleep, for when she wakes the world will shake." So, purportedly, said Napoleon some 200 years ago. In Beijing this week European leaders have been telling their Chinese counterparts that such unease is at risk of spreading. Once content to let the Americans do the worrying, the EU is joining in.

In the build-up to an annual China-EU summit in Beijing on November 28th, European officials raised hackles by complaining about Chinese trade practices and exchange-rate policy in the kind of direct language that China had thought an annoying American trait. The European Commission's president, José Manuel Barroso, told Communist Party officials that the emergence of China risked being seen by Europeans "as a threat". Mr Barroso gave warning of "protectionist pressures which would be very difficult to contain" if nothing were done to curb the EU's huge trade deficit with China.

Peter Mandelson, the EU's trade commissioner, was similarly blunt on China's rampant abuse of intellectual-property rights. "The problems continue to get worse, and the world—particularly China—is changing too fast to wait longer," he said in Beijing. It was hard, he said, to see how much longer Europe's patience would last. He also took a swipe at China for suggesting that European concerns about the safety of Chinese products were being used to excuse protectionism. Wu Yi, a deputy prime minister, said she was "extremely dissatisfied" with his remarks.

Europe's disquiet is likely to grow. Last year its trade deficit with China reached €131 billion ($164 billion), say EU figures. This year it is expected to grow to €150billion-160 billion, on a par with America's record deficit with China in 2006 (see chart). That is the more disturbing for Europeans because they are not used to it: for years, their trade deficit was China was modest. The yuan has been appreciating slowly against the dollar in the past couple of years. But it has been declining against the euro. This is making Chinese imports even cheaper for Europeans—good news for consumers and companies making products in China for export to Europe, but bad news for exporters and uncompetitive industries in Europe itself.

China is showing little sign of yielding to European and American complaints about what those countries see as a grossly undervalued yuan. The official line remains that any change should be gradual. Nor is it anxious to take up the grouses of European and American companies about the difficulties of doing business in China. A survey released last week by the European Chamber of Commerce in China showed that many responding companies felt that China was trying to circumvent the market-opening commitments it made to the World Trade Organisation.

Once hopeful that the EU might act as a counterbalance to American power, China's expectations have receded as more pro-American leaders have taken over in Germany and France. The EU may be China's biggest trading partner, but it ranks far lower in China's political calculations. A report from Chatham House, a British think-tank, says China believes Europe lacks strategic vision and suffers from internal discord, impeding its credibility.

It also argues that China has a clear understanding of EU institutions. It is certainly true that China has been exploiting EU divisions to the full. Following an unprecedented meeting in September between Germany's chancellor, Angela Merkel, and Tibet's exiled leader, the Dalai Lama (see article), China has vented its rage by cancelling a number of engagements with Germany, its largest export market in the

EU.

By contrast it gave a warm welcome to France's president, Nicolas Sarkozy, who visited China just before the EU summit, conspicuously neglecting to bring his human-rights minister along. Mr Sarkozy oversaw the signing of a deal worth $11.9 billion for the sale of two French nuclear reactors to China and another for the sale of $17 billion-worth of Airbus aircraft.

China takes America more seriously. Its punishment of Germany has been tougher than its response to the first public appearance by an American president with the Dalai Lama in October. But even with the Americans, China let its pique be known. Last month it abruptly blocked a Thanksgiving visit to Hong Kong by the American aircraft carrier *Kitty Hawk* and her escorting ships, until it was too late for them to change course before the holiday. At least America's Treasury secretary, Hank Paulson, is still due to visit Beijing this month. But like those of Europeans, his concerns about the yuan and trade imbalances will receive a polite brush-off.

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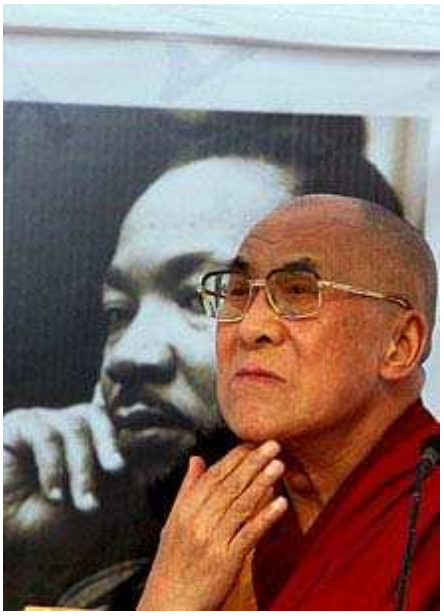
The Dalai Lama

# Heresy!

Nov 29th 2007 | BEIJING
From The Economist print edition

**Communists can live with reincarnation. A referendum is a different matter**

EPA



**Plotting his comeback**

THE Chinese government's web portal has an odd-looking entry on its page listing laws that came into force in September. Buried among new regulations on issues ranging from registering sailors to monitoring pollution is one on how to manage the reincarnations of living Buddhas. Violators are threatened with prosecution. China's Communist Party—though avowedly atheist—does not hesitate to pontificate on religious matters that it sees as having a political dimension. Living Buddhas make up the senior clergy of Tibet's religion. They are traditionally selected from among boys considered to be reincarnations of deceased office-holders. Controlling the selection process, in the party's view, is crucial to controlling Tibet.

Tibet's exiled leader, the 14th Dalai Lama, who is 72, knows this too. China, already enraged by his recent high-profile meetings with George Bush and Germany's chancellor, Angela Merkel, is now incensed by his proposal that in selecting the most critical reincarnation of all, his own, new procedures may apply—his, not China's.

He has long has said he may not be reincarnated at all, or, if Tibet is not free, that he may be reborn outside China. This would do much to undermine any attempt by China to appoint its own Dalai Lama in the way it chose a new Panchen Lama, the second highest-ranking leader of Tibetan Buddhism, in 1995. (A rival reincarnation endorsed by the Dalai Lama, a boy living in China, has not been seen since.) Recently the Dalai Lama has gone further, proposing that his successor be chosen while he is still alive, by himself or by senior monks. And this week he even suggested that Tibetans could hold a referendum to decide on the Dalai Lamas' future.

Appointing the 15th Dalai Lama during his predecessor's lifetime would be a huge blow to China. It would enable the new incarnation to gain credibility among Tibetans before China has a chance to appoint its own puppet. Moreover, a referendum, introducing the idea of a popular mandate, might not be heretical to Buddhists. But it is to the party. Given China's opposition, it would be limited to Tibetans abroad, and would doubtless endorse the Dalai Lama's wishes. China called the ideas a violation of religious rituals and tradition. Who better than the party to judge?

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Myanmar's Rohingyas

# No place like home

Nov 29th 2007 | SITTWE AND TAL CAMP
From The Economist print edition

**Stateless and homeless, Myanmar's Muslims have been abandoned by everyone**

AS UNREST in Myanmar kindled flickering hopes of political change, long-suffering refugees in Bangladesh were glued to their radios. They hope for a chance to reclaim their land and their dignity. Sadly, they may be waiting in vain. Not only are there scant signs of change from the repressive ruling junta. But these are also Rohingyas, members of a poor Muslim minority never very welcome at home.

The junta's persecution of Muslims has been extreme. But anti-Muslim sentiments have been simmering for centuries in Burma. The dark-skinned Rohingyas, who have more in common physically and culturally with Bangladeshis than with most Burmese, have always suffered abuse.

The junta has ostracised them, by refusing full Myanmar citizenship, calling them only “residents of Rakhine state”. Almost all the roughly 800,000 Rohingyas today are stateless. The military regime routinely presses them into slave labour, severely restricts their rights to travel and marry, and denies them access to both medical care and education.

In Sittwe, the capital of Rakhine (formerly Arakan), Rohingyas lead desperately poor lives. Those not pressganged into road construction at meagre wages live by subsistence farming and fishing. “It's because we're Muslim,” declares a trishaw driver. He says people give work to Buddhists. There are many poor Buddhists in Sittwe too. But the perception of unfair treatment lingers amongst Muslims, though some made common cause with September's anti-government protesters.

Rohingyas have been fleeing Myanmar for decades. Many mingle among the million or so illegal Burmese migrants living in Thailand. And the office of the United Nations High Commissioner for Refugees (UNHCR) has documented 12,000 in Malaysia, but admits there may be twice that number. The largest number has fled to Bangladesh. But the Bangladeshis have been reluctant hosts. Citing overpopulation and land

scarcity, successive governments have forcibly repatriated the refugees: 250,000 were expelled between 1991 and 1992, and almost as many since.

Since 1992 Bangladesh has refused to grant the Rohingyas refugee status. Only two official UNHCR camps now remain near Chittagong. But most of those repatriated to the same dire conditions they had fled have trickled back to squat in makeshift shelters and camps just across the border. Today around 8,000 live in an unofficial camp called Tal. Another 200,000 have settled in the surrounding area.

Tal was born out of Operation Clean Heart, a 2002 crackdown in which thousands of Rohingyas were rooted out of local villages. Frido Herinckx of Médecins Sans Frontières, an aid organisation, describes how the police threatened local Bangladeshis with prison unless they reported on their Burmese neighbours. Instead of returning to Myanmar, thousands of homeless Rohingyas regrouped and settled on a 30-metre-wide stretch of mud along the banks of the Naf River.

In Tal as many as 12 people are crammed into flimsy shelters patched together from reeds and plastic sheets. Floods regularly inundate the camp, and local hostility to the incomers often leads to violence. Still, most feel that life there is preferable to the daily humiliations suffered in Myanmar. “If I can't even say ‘this house is mine,' how can I live there?” asks one 32-year-old man. He says the regime confiscated all he had.

The government in Bangladesh has recently shown signs of softening its policies. It plans to move Tal to a drier and more permanent location. Aid workers hope the Rohingyas will eventually be granted Bangladeshi citizenship. Most Rohingyas say that if democracy is established in Myanmar, they will go back. But the junta is not their only enemy.

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South Korea

# Dirty laundry

Nov 29th 2007 | SEOUL
From The Economist print edition

**World-bestriding Samsung faces a little local difficulty**

CYNICS in South Korea, and there are many, expect the scandal now engulfing the country's biggest conglomerate, or *chaebol*, simply to fizzle out. Samsung stands accused of bribing politicians, bureaucrats and prosecutors to do its bidding. Samsung, whose businesses—from electronics to shipbuilding—produce revenues equivalent to one-fifth of South Korea's GDP, calls the allegations “ungrounded and untrue”. Whatever their basis in fact, this is an election year and the economy is, as ever, the voters' biggest concern. So many believe the investigations into the accusations will end with Samsung receiving a slap on the wrist, at worst.

Yet it may turn out differently. Samsung's accuser is no ordinary whistleblower. He was the group's senior legal officer, Kim Yong-chul, the first insider to make such allegations. At first only one newspaper, *Hankyoreh*, regarded as a provocative gadfly, dared print them. Many in South Korea believe the press coddles the *chaebols* because of their clout as advertisers.

Frustrated by the tepid response, Mr Kim turned to the Catholic Priests' Association for Justice (CPAJ). This 33-year-old group played a leading role in ending South Korea's military dictatorship in 1987. So when it held a news conference the big papers could not ignore it. Mr Kim said Samsung had more than 1,000 bank accounts, including some under his own name, which were used for bribery. And he said executives put pressure on witnesses and prosecutors during a trial about the legality of a sale of securities by Lee Kun-hee, Samsung's chairman, to his son, Lee Jay-yong, which enabled the younger Mr Lee to take control of the group's holding company.

Prosecutors have already launched one investigation. After a public outcry, another inquiry by a special independent prosecutor was announced. Lee Kun-hee has been banned from leaving the country. Song Ho-chang, of Lawyers for a Democratic Society, a group backing Mr Kim, believes South Korea has made much progress in reducing the collusion between business and politicians.

Others argue that bribery by leading business groups remains deeply rooted and that no president has had the courage to tackle it. The current president, Roh Moo-hyun, promised to break the power of the *chaebols*; he has done nothing. Many in South Korea believe the *chaebols* have to make their business dealings more transparent. Dynastic succession has to go, they say: we are not North Korea.

The whistleblower himself has sought sanctuary. Mr Kim is housed and fed by the CPAJ. Meanwhile a whispering campaign against him is making its way around Seoul. Father Kim In-kook of the CPAJ defends him: “He spent a lot of time thinking what he should do; and he has concluded that uncovering these actions by Samsung will benefit society.” But Father Kim declined to meet *The Economist*, saying his group had made a collective decision not to talk to foreign reporters about the Samsung allegations. “We don't want to air Korea's dirty laundry to the world,” he said. They have that, at least, in common with Samsung.

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Java's unstoppable mudflow

# Slimy business

Nov 29th 2007 | PORONG, EAST JAVA
From The Economist print edition

**The mud does not stick**

Reuters

**Up to his neck in it**

FARMERS tilling the fields of Java, the world's most populous island, have long known that the gods give and they take away. Java's volcanic soil is astonishingly fertile but, like the rest of Indonesia, alarmingly prone to seismic activity. An earthquake that struck the eastern island of Sumbawa on November 25th killed at least three people.

But the calamity that has befouled a swathe of semi-industrial farmland in east Java was, by most accounts, a man-made mess. In May last year Lapindo Brantas, an energy company, was drilling for natural gas when it accidentally opened a fissure in the ground. Torrents of hot, toxic mud began to flow. It has been flowing ever since, inundating 11 villages and swamping schools, factories, farms and roads in a 2.5 square mile (6.5 square km) zone. A network of earthen dams and levees holds back a lake of oily grey muck. Some is being pumped into a river and out to sea, despite the risk of contamination from heavy metals and chemicals in the mud.

Efforts to staunch the flow have ranged from the ambitious to the ludicrous. Hundreds of concrete balls linked by steel cables were air-dropped into the hole, to no good effect. A group of Javanese mystics, offered a cash reward by local authorities to plug the abyss using supernatural powers, fared no better. Various experts have offered advice on how to divert or disrupt the volcano, which has spewed out an estimated 1 billion cubic feet (28m cubic metres) of mud. Japanese scientists have proposed building a 130-foot (40-metre) dam, reasoning that the weight of the exposed mud, which hardens as it dries, would eventually stem the flow. Nobody knows if or when it would stop of its own accord.

A hand-painted banner across an abandoned strip of toll-road offers its own succinct formula: “Lapindo + Government = Madness”. Many are angry at the government's sluggish response to the disaster, which has displaced some 16,000 people. Hundreds are still living in a makeshift camp. The local economy has collapsed. Factories and farms have been inundated, and the vital toll-road to the port of Surabaya closed. To ease the appalling traffic a military airport in Malang, a town to the south, has opened to civilian flights.

Apportioning blame for the disaster has been tricky. Lapindo argued the mudflow was caused by an earthquake that struck central Java two days earlier, a theory pooh-poohed by most geologists. After much dithering, Susilo Bambang Yudhoyono, Indonesia's president, ordered the company to pay $412m to the afflicted. But inundated villagers get just 20% now, and the rest within two years.

Mr Yudhoyono may be influenced by Lapindo's majority shareholder, the diversified family-owned Bakrie Group. At the time of the disaster, its patriarch, Aburizal Bakrie, was the economics supremo in Mr Yudhoyono's cabinet, having backed his presidential campaign in 2004. Mr Bakrie described the mudflow as a natural disaster that “nothing can prevent”. Perhaps to escape liability, his group tried to sell Lapindo to obscure offshore buyers. But Indonesian regulators blocked the sale. Mr Bakrie has since moved, with no intended irony, to the post of co-ordinating minister for public welfare.

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The Arab-Israeli summit in Annapolis

# Big turnout, small result

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From The Economist print edition

AP

**An agreement on further peace talks, if not much else**

THEY almost didn't make it, but in the last hour Ehud Olmert, the Israeli prime minister, and Mahmoud Abbas, the Palestinian president, agreed on a joint statement. Four months of preliminary talks had failed to produce what Mr Abbas and Condoleezza Rice, the American secretary of state, had hoped to brandish at this week's peace summit in Annapolis: an agreement to predetermine some aspects of the final-status deal that would ultimately create a Palestinian state next to Israel. In the end, Ms Rice had to settle for less, but the Palestinians and Israelis did agree two things. Final-status talks will begin on December 12th. And the United States will monitor both sides' compliance in the meantime with the "road map" peace plan of 2003, under which Israel is meant to freeze settlement-building in the West Bank while the Palestinian Authority (PA) takes action against militants who attack Israel.

Both these agreements still lack some important detail, however. While teams of negotiators will work continuously to hammer out all the issues of a peace deal—the borders of the Palestinian state, the division of Jerusalem, the fate of 4.5m Palestinian refugees abroad, the sharing of water resources, and so on—nobody has specified whether the starting point will be a blank slate or a previous near-deal such as the informal 2001 Taba agreement negotiated in Egypt. That could make a big difference to how fast things progress. So too could the fact that there will be no American go-between for them.

Likewise, the United States has agreed to supervise both sides' compliance with the road map; a potential win for the Palestinians since in the past Israel has been the de facto arbiter of performance. But it is unclear how, and how strictly, America will actually do this. So far, it has only appointed a general, James Jones, as a security envoy to the PA. Much clearer is that Israel will not make his job easy. An Israeli official says that any impression that Mr Olmert plans a total construction freeze, as the road map stipulates, is a "convenient misperception".

A more telling measure of Mr Olmert's intentions may be how vigorously he goes after the 100-plus "unauthorised" outposts established by hardline settlers, of which the road map requires him to dismantle around 60. Previous attempts to take even one down have led to violent clashes between the police and settlers, who are regrouping for a showdown after losing their fight to stay in the Gaza Strip in 2005. As for the Palestinians, the American arbitrator will find himself squeezed between the Israeli reading of the road map—that the PA must entirely dismantle terrorist groups before any final-status deal that the two sides reach can go into effect—and the Palestinian one, which is that it need only get the task well under way.

The two sides hope to conclude the final-status deal itself within a year. But given the complexity of the issues and the fragile politics on each side, this looks over-ambitious to some. Mr Olmert will have to keep conceding enough to keep the peace process going, but not so much that it prompts right-wing parties to leave his coalition. They have already started throwing out banana skins, such as a parliamentary bill earlier this month that would make it much harder for Israel to give up any of Jerusalem to the PA. Mr Abbas, for his part, having got much less out of Annapolis than he originally insisted on, is vulnerable to the jibes of Islamist opponents. His security forces have been cracking down with unusual harshness on anti-Annapolis demonstrations in the West Bank this week, something that could cost him precious legitimacy.

## A coalition of the fearful

For a conference so thin on content, though, Annapolis was surprisingly thickly attended. Few expected Saudi Arabia to send its foreign minister, but there he was, along with 40 leaders, many from Islamic states without diplomatic ties with Israel. To what extent this is a victory for President George Bush, though, is also not yet clear.

One reason the Arabs showed up, as American officials argue, is because they may share Mr Bush's desire to create a united, mostly Sunni front against mostly Shia extremists led by Iran. Syria's decision to send its deputy foreign minister—less than a full negotiator, but more than just a token presence—in return for a merely token discussion at Annapolis about Syrian-Israeli peace may have signalled that Syria, too, is worried about ending up on the wrong side of the barricades. The show of solidarity certainly produced some alarmed noises from Tehran and fist waving from its Islamist allies, Lebanon's Hizbullah and the Palestinians' Hamas.

Yet the Saudis and others may also have come because they felt they had no choice. It would have been too easy for America to paint them as the cause of Annapolis's failure. With Lebanon fearing more civil conflict as it tries to break a deadlock over the election of a president, Syria's role is crucial; some, indeed, think its invitation to Annapolis is what has prevented Lebanon from exploding already. But Mr Bush offered Syria no concessions, instead giving it a clear rebuke in his speech with a reference to Lebanon's need for an election “free from outside interference and intimidation” (see article). The question now is whether America can convert the show of support it got at Annapolis into anything more substantial.

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Lebanon

# In search of a government

Nov 29th 2007 | CAIRO
From The Economist print edition

**Even as the country's people get used to not having one**

AFP

**Lahoud delighted them long enough**

FOR months, November 23rd loomed as a critical date in Lebanon's turbulent politics. This was the final day of President Emile Lahoud's term of office, and the Lebanese parliament was constitutionally bound to elect a successor before that deadline. Failure to choose a new head of state, many said, could precipitate a slide into chaos and even a renewal of the 1975-90 civil war.

In the event, nothing happened. Mr Lahoud marched past an honour guard and into the sunset. The prime minister, Fouad Siniora, announced that his cabinet would assume presidential functions temporarily, while both his majority faction and its opponents pledged to continue working towards a compromise.

Tensions are still high, but fears of imminent strife appear to have dissipated. Ordinary Lebanese have resumed daily business with their customary mix of bemusement and despair. After all, their country has muddled along, just, without a legislature, and, some would say, without a legitimate government, since last November, when the opposition launched a boycott of cabinet and parliament.

During this time divisions between the ruling majority, a coalition of Sunni Muslim, Druze and smaller Christian factions, and its opponents, an alliance of Shia and populist Christian groups, have solidified. The core dispute, which erupted in the wake of the bruising Hizbullah-Israeli war in the summer of 2006, concerns opposition demands for a bigger share in government. But this represents only one layer in an onion-like ball of issues that is rendered still more complex by the influence of foreign powers such as Iran, Syria, France, America and Saudi Arabia, each of which is widely viewed as sponsoring “clients” among Lebanon's factions.

Some Lebanese link the latest delay in finding a president to the Bush administration's launch, at Annapolis this week, of a push for Middle Eastern peace. Until the last moment, it had not been clear whether Syria, the main power broker in Lebanon until it was ousted in a popular uprising in 2005, would join the parley. Its inclusion, which had hinged on Syria's demand that its own territorial dispute with Israel be put on the table, may hint at a possible deal, whereby Syria might push its Lebanese allies towards compromising over the presidency in exchange for renewed international attention to its claim on the Golan Heights, which Israel occupied in 1967 in the six-day war. Conspiracy theorists whisper that Syria may also hope for a softening of the ongoing UN investigation into political assassinations in

Lebanon that have been widely linked to Syrian agents.

Yet there are also important Lebanese internal dynamics at play. The country's fragile political system splits power in rough thirds between its three largest sects, by means of rules stipulating that the president should be a Maronite Christian, the prime minister a Sunni and the speaker of parliament a Shia Muslim. The Muslim sects enjoy more or less united leaderships, but have grown increasingly antagonistic to each other. Christian Lebanese tend to feel that their inability to fall in behind a single leader has diluted their influence, and also prevented them from playing a balancing role.

Mr Lahoud, who was installed during the period of Syrian dominance, was widely loathed. The most popular Maronite politician, Michel Aoun, has strong anti-Syrian credentials, but his volatile nature and alliance with Hizbullah alienate many Christians. His closest rivals are also unable to gain the needed two-thirds of votes, leaving the presidential field to lesser-calibre figures. In one attempt at compromise, the government and opposition agreed to let the head of the Maronite church, Cardinal Sfeir, draw up a list of potential candidates. The two sides then vetoed them one by one.

But one appears to have survived this shooting gallery. The army commander-in-chief, Michel Suleiman, has gained respect for keeping his men above the political fray, and using them effectively to maintain security. Although many Lebanese would be relieved to see the low-key general as president, his election requires a change to constitutional rules barring soldiers from civilian office. In a possible sign of light at the end of a long tunnel, Mr Siniora's government now says that it would back such an amendment.

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Mozambique

# Not quite as stellar as it looks

Nov 29th 2007 | MAPUTO
From The Economist print edition

**One of Africa's success stories comes in for some closer scrutiny**

AS A shining example of a happy transition from war to peace, Mozambique has won a lot of plaudits. In October Joaquim Chissano, the country's former president credited with much of its recent success, won the first Mo Ibrahim prize for retired African rulers. In November the accolades came from the World Bank, which praised Mozambique for being among the region's top business reformers. Enthusiastic donors poured $1.3 billion into the country in 2005—about a fifth of its GDP. Does Mozambique deserve the acclaim?

It has certainly come a long way from the early 1990s. Then, it was left exhausted and destroyed by years of war, first for independence against Portuguese colonial rule and afterwards between two domestic foes, the ruling Front for the Liberation of Mozambique (Frelimo) and the opposition Mozambican National Resistance (Renamo). But they have beaten their swords into ploughshares and now argue out their differences at the ballot box. The ruling party dropped its Marxist credo 20 years ago, though some of the rhetoric remains. The economy has grown by an average of 8% a year since 1996, and the IMF expects inflation this year to dip under 10%.

Mozambique has become a magnet for foreign investors because of its minerals. The Mozal aluminium smelter near Maputo started the rush in the 1990s; more recently several mining companies have done deals to dig for coal and ilmenite, which can be turned into titanium dioxide, a base for paint, paper and plastic. Foreigners are also interested in biofuels. The Chinese want to build several dams. With the main roads de-mined and patched up, you can drive fairly easily from Maputo, the capital down south, to Pemba, some 1,650 kilometres (1,025 miles) north.

The southern provinces had always done relatively well, mainly because they are close to the regional behemoth, South Africa. But now the north is picking up. Bright new banks, petrol stations and hotels have opened in the northern town of Nampula. In contrast to a few years ago, telephones are working, electricity is fairly reliable and water is running. The province's dynamic new governor, Felismino Tocoli, is very friendly to business.

Five years ago António Miranda, who once worked for Coca-Cola, put his savings into a cashew, macadamia and vegetable-oil business. Today he employs 1,900 people. Though red tape remains mind-numbing, labour laws crippling, land ownership a headache and access to cash difficult, he thinks the region can take off. Like most of the north, it has rich soil, lots of undeveloped land and a good climate for farming. Andrew Cunningham, a Zimbabwean farmer, started a poultry business in Nampula two

years ago. New Horizons relies on 210 subsistence farmers to raise chickens, providing training and inputs. Celestine Monquante, who lives at the end of a dirt road about 37km east of town, has just received a new supply of chicks, which he and his wife will rear for about a month in a coop they built next to their mud hut. He used to scrape a living cutting wood to make charcoal. Last year, chicken money paid for food, school fees and new clothes for Mrs Monquante.

But some people are sceptical. Carlos Castel-Branco, a local economist, says the economy is not really developing. Growth is driven by foreign aid and big capital-intensive foreign investments, which, he argues, create few jobs and contribute little to the public purse. After two decades, Mozambique still depends heavily on foreign aid, while the domestic economy has failed to develop or diversify. The Mozal aluminium smelter contributes almost three-quarters of the country's exports. Meanwhile, some two-thirds of Mozambicans still live in the countryside and depend on small-scale farming, drifting in and out of poverty.

Moreover, many of the businesses that do exist depend on political patronage. So far, the country's growing wealth has largely benefited a tiny elite, breeding resentment among the small middle class. “The tentacles of the ruling party are in almost every sector of the economy,” says a local journalist. Until his death last week Mr Chissano's son Nympine was being investigated in connection with the murder in 2000 of a journalist who had been sniffing out corruption.

The conciliatory spirit of the 1990s has given way to a less tolerant stance. Renamo says its supporters in rural areas are being harassed and sometimes beaten up. The pressure on civil servants to join the ruling party is growing. Much of the extra money given to local authorities for economic development is said to end up in the pockets of Frelimo people.

Armando Guebuza, who succeeded Mr Chissano in 2005, draws support from more radical factions of the ruling party, which appear keen to re-establish a firmer grip on power. Afonso Dhlakama, the lively Renamo leader, complains that Mr Guebuza, unlike his predecessor, is not a man of dialogue. Frelimo retorts that the new president may have a different style but his policies are the same.

Many foreign donors' favourites—think of Ethiopia and Uganda—have recently proved to be disappointments, especially on the human-rights and political front. In the next two years, Mozambique is due to hold a series of local and national elections. They will show which way the wind of democracy is blowing.

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Uganda

# Still gripped by fear

Nov 29th 2007 | OBER ABIC
From The Economist print edition

**Northern Uganda struggles to recover from the Lord's Resistance Army**

ON THE morning of October 2nd Vincent Otti, the deputy leader of the Lord's Resistance Army (LRA), was led out into a clearing in the Garamba rainforest in northern Congo and shot dead, together with his supporters. The bodies were left to rot for three days, to “strengthen the spirit” of Joseph Kony, the leader of the LRA, who ordered the executions. Mr Otti's wives were distributed among Mr Kony's loyal lieutenants. At least, this is what the Ugandan government claims. The LRA, on the other hand, insists that Mr Otti is alive, just indisposed variously with fever, cholera and latterly house arrest.

The claims and counter-claims have come as northern Uganda is beginning to return to something approaching normality after the end, it is hoped, of the LRA's 20-year insurgency against the government. Peace talks between the two sides have encouraged some of the 1m-odd people displaced by the conflict to leave their refugee camps and return to rebuild their villages. Curfews have been abolished. Wells are being drilled.

But that sense of increasing physical security remains precarious, and psychological security is something else. The LRA is a small force, with perhaps only 2,000 fighters holed up in Congo, but Mr Kony claims supernatural powers and his methods are barbaric: hacking open heads and limbs, slicing off ears and noses, gouging out eyes, padlocking vaginas, and abducting both adults and children. The violence is worth emphasising because it explains the almost demonic grip the LRA has over the displaced. A single LRA bullet, say aid workers, would be all it would take to send the resettled back to the camps.

The LRA has used the peace talks to depict itself as an army fighting for the rights of the north. It hopes for positions in Uganda's government (Mr Otti fancied being vice-president), much as Sudan's southern rebels won cabinet posts under that country's comprehensive peace agreement of 2005.

Northerners just want the force to disappear. Cosmos Akena, the head of Ober Abic village in the far west of Acholiland, trembles when asked about the LRA. He was abducted twice by the group, he says, but escaped. His village was abandoned and has only recently sprung back to life. There is not much to it; a few grass huts (some roofless), a primary school and a clinic. The children are barefoot, in tattered rags or naked, their bellies swollen with worms; traditional community life broke down in the centralised camps.

The LRA hideouts in Congo are a long way away from Ober Abic, but still the sense of exposure here is palpable. The village is at the end of a dirt track and the bush unfurls beyond in a pale sea of thorn and scrub, fading unbroken into Sudan and Congo. The school is closed; no teacher is brave enough to take the post. The World Food Programme (WFP) provides the village with 40% of its food, in monthly handouts. The rest is scraped out in cassava and banana from what should be a fertile land but is unforgiving; this year's harvest has failed. Still, the WFP reckons it can pull back in a couple of years if the LRA is disbanded.

That is a big if. Defections make the LRA less stable. Mr Kony may be selling the food aid he receives to rearm. Uganda's president, Yoweri Museveni, may also be dragging out negotiations in the hope of smashing Mr Kony militarily. Some think the Sudanese president, Omar al-Bashir, who has supported the LRA, wants to keep the fighters in play to destabilise south Sudan, if needed.

Then there is the question of justice. The International Criminal Court (ICC) is determined to try Mr Kony and his lieutenants for crimes against humanity. Some Acholi say they would be willing to judge him according to their local laws; anything for peace. They believe that the spirits of the dead will anyway drive the LRA commanders demented.

But this will not work. The LRA brutalised the entire north of Uganda, not just Acholiland, and young Acholi know little of, and care less about, traditional justice. Given the precedent it would set, the ICC can hardly back down now. Some think an unhappy compromise may be needed, with Mr Kony settled in a third country, while the ICC prepares a case against him until the end of his days.

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Uganda and the Commonwealth

# Museveni, munificent with monarch

Nov 29th 2007 | KAMPALA
From The Economist print edition

## Burying the ghost of Idi Amin

Reuters

THE best line at last week's Commonwealth heads of government meeting in Uganda was the unwitting statement of local religious leaders against gay rights. “We are telling the queen,” a bishop earnestly told reporters, “that by embracing homosexuality we shall not have kings and queens.”

But the prize moment for Uganda's president, Yoweri Museveni, came when addressing the country's Parliament in the presence of Her Majesty. He received hearty applause for his assertion that Uganda was among the most democratic countries in the world, a democracy built on respect for the constitution. That was rich indeed, considering that Mr Museveni changed the constitution to allow himself a third term. The foot-stamping came entirely from his own National Resistance Movement, which won 205 of 289 parliamentary seats in last year's disputed election. The queen, cannily, remained expressionless.

Still, the Commonwealth meeting put Mr Museveni back in respectable circles after years of thuggish behaviour and accusations of corruption. Britain, the former colonial power, which had cut aid, has now promised a whopping $1.4 billion in regular instalments over the next decade. That will help free Mr Museveni to try and realise his dream of becoming the first president of some kind of east African federation, also including Kenya, Tanzania, Rwanda and Burundi.

The more immediate question for locals was whether so much money spent on a three-day meeting of Commonwealth all-sorts was worth it. Ugandan businessmen, and not just those in government circles, certainly thought so. New hotels, an improved airport and a favourable tax regime may attract investors. More importantly, it was a chance to bury the ghost of Uganda's most infamous son: Idi Amin, cannibal, soldier, dictator and buffoon.

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Russia's election

# Putin's phoney election

Nov 29th 2007 | MOSCOW AND TVER
From The Economist print edition

Reuters

**What lies behind this weekend's sham parliamentary election**

"MARIA", a teacher in Tver, near Moscow, felt ashamed when she told her 15-year-old pupils to join a rally in support of President Vladimir Putin before this weekend's parliamentary election. The order came from the local administration, staffed by members of the pro-Kremlin United Russia party. "I would not have lost my life or even my job if I had not followed the order. But I felt I could not refuse it, perhaps because I am not a free person. Ten years ago I would have told you my real name," she sighs. Her pupils were given Russian flags to wave, but the sound system was so bad they could not hear the speeches. It was not until later that they learnt from television that they had joined in an "outburst of patriotic feeling".

Tver was chosen because it is the land of Mr Putin's forebears, but similar "voluntary" demonstrations have been staged all over Russia. A local theatre in Tver hosted a council of pro-Putin groups. Anyone who is for Mr Putin is for United Russia, they decreed. Or, to put it the other way round, anyone who is against United Russia is against Mr Putin. When the president decided to head United Russia's party list, its poll rating jumped from 50% to 63%.

Yet Mr Putin is not even a member of United Russia. The party is no more than a vehicle. If the advertising banners hung across streets in every Russian town are a guide, most of the country will vote for their president on December 2nd, even though he is not up for election. Indeed, the exercise is not really an election at all. It is not about political competition and does not have fair rules. It is about confirming that power in Russia lies with Mr Putin, who has presided over an oil-driven bonanza for his country.

Only candidates approved by the Kremlin are allowed to take part. Besides United Russia, which could secure 70% of the vote, these include the toothless Communist Party (which may get 12%) and the Liberal Democratic Party, a clownish far-right party set up in the late 1980s with the help of the KGB. (Its party list includes Andrei Lugovoi, the ex-KGB officer accused of poisoning his former colleague, Alexander Litvinenko, in London last year.)

The results were fixed months ago, when the Kremlin changed the rules. To keep the opposition out of parliament, the Kremlin raised the threshold for seats to 7%, and banned small parties from forming coalitions to meet this requirement. The minimum turnout rule was abolished, as was the option to vote against all candidates. Regional parties and single-mandate seats that let in independent deputies were scrapped. Opposition leaders have been harassed or arrested and their financing blocked. Television has given blanket coverage to United Russia and dished dirt on all opposition. This propaganda has been so

effective that, despite United Russia's refusal to participate in TV debates, 8% of viewers believe they have seen it win them. The opposition Union of Right Forces (SPS) has not been allowed to air an advertisement warning the country against a return to the Soviet past.

Why have a people used to Soviet elections, when they had only one candidate, found the Kremlin's machinations so palatable? One reason is that Russian economic growth, sparked by the privatisations of the 1990s and kept going by the oil-price boom, has brought rising living standards and a new sense of stability. This, as well as his control of television, has made Mr Putin genuinely popular. Even the teacher from Tver says her life has improved.

The sense of stability is based largely on hopes that the crises of the 1990s will not return. Opinion polls suggest that half the people do not expect anything from this election; most believe that elections serve only those in power. Most voters say the results will be rigged anyway. Only 5% of Russians are ready to protest. “Nothing depends on us,” says one woman. Yet she will vote for Mr Putin—who else? Even those who once backed the SPS will stay at home: what is the point if they are bound to lose? Worse, some 35% of Russians prefer the Soviet political system. Two-thirds of Russians consider the concentration of power in Mr Putin's hands to be a good thing. Most would like him to stay for a third term. The strength of the Kremlin lies in the lack of any resistance to it, says Lev Gudkov, head of the Levada Centre, an independent pollster. Indeed, the only danger for the Kremlin is the possibility of an embarrassingly low voter turnout.

To guard against that, Mr Putin recently gave a rousing speech at a stadium in Moscow, broadcast on every television channel. Standing on a neon-lit catwalk in a black turtle-neck jumper, surrounded by thousands of flag-waving Putin youths, the president said Russia was in danger from ill-wishing foreigners and thieving liberals. “Those who oppose us need a weak, sick state, a disorientated, divided society, so that behind its back they can get up to their dirty deeds and profit at your and my expense,” he said. “Unfortunately there are jackals inside the country who sponge off foreign embassies.”

The message is clear. Russia's enemies are the liberals who in the 1990s squandered its wealth, cut defence spending and led people into poverty. They are now the candidates and sponsors of the opposition. The security services and police took Mr Putin's words as an instruction. When the opposition gathered in Moscow and St Petersburg as part of the Other Russia movement, which has not been allowed to register for this election, many people, including journalists, were beaten up and arrested. These scenes, broadcast around the world, were not shown on Russian television. Russians did not hear opposition speeches; they were not told that candidates had been unlawfully detained by the police; nor that Garry Kasparov, leader of Other Russia, was forbidden to meet his lawyer and jailed on bogus charges.

Equally, Russian television has largely ignored angry anti-government demonstrations in Ingushetia, a republic next to Chechnya where a six-year-old boy was killed recently in a skirmish between Russian commandos and local militants. Three journalists and a human-rights campaigner who came to cover the protest were abducted from their hotel and beaten up. What viewers have seen instead were pictures of fountains in Chechnya and of polite policemen in Moscow helping old ladies and children.

The paradox is that the Kremlin would surely have won even had this weekend's election been free and fair. Its heavy-handed tactics betray the nervousness linked to the transition of power in any authoritarian system. A power struggle is clearly taking place within the Kremlin, as shown by the arrests of senior officials in different camps. Mr Putin needs to retain power after his second term expires next March, but at the same time to preserve legitimacy. It is not an easy task.

This is why the parliamentary election has been turned into a ceremony of approval for him. A score of 70-75% of the vote, on a turnout of 60%, as planned by the Kremlin, would strengthen his claims to continue to lead the country. If Mr Putin cannot stay as president because the constitution bars him from a third consecutive term, he should take power with him wherever he goes. Dmitry Peskov, his spokesman, is adamant: Mr Putin will not be president after next March. But his every word will still be awaited, his every written statement demanded by newspapers. A servile president handpicked by Mr Putin and elected with a majority of, say, 51% will be unable to compete with Mr Putin's “legitimacy”, says Mr Peskov.

Some Kremlin insiders think Mr Putin could make himself head of the powerful Security Council, whose functions may then be pumped up. Others suggest he could become prime minister, with extra powers, before returning to the Kremlin to replace the president, who could conveniently fall ill. The only problem of Mr Putin's system is that stepping aside even for a short time could be lethal for him and his cronies. And that is why Russia, despite the predictability of this election, feels like a country heading towards

crisis.

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French riots

# Le Paris flambé

Nov 29th 2007 | PARIS
From The Economist print edition

Rex

**A night on the tiles in Paris**

**Once more Nicolas Sarkozy has faced rioting in the French suburbs**

Get article background

TWO years ago, it took three weeks and a state of emergency to end the riots in France's troubled *banlieues*. So when violence broke out this week in Villiers-le-Bel, a rough suburb north of Paris, President Nicolas Sarkozy, interior minister in 2005, was determined to prevent a repeat performance. Police reinforcements, brought in after two nights of car-burning and confrontation, helped to calm the streets. Yet fears remain that, at the slightest provocation, the violence could start again.

As in 2005, the riots were triggered by the deaths of two youths in a clash with police. This time two teenagers, riding a mini-motorbike without crash helmets, were killed in a collision with a police car on November 25th. How it happened is unclear; a judicial inquiry has begun. But by nightfall, rioters were on the rampage. Over two nights of violence, they torched scores of cars and rubbish bins, a police station, a nursery school, a library, shops, a car dealer and a McDonald's. Other *banlieues* north of Paris and in Toulouse saw car-burnings. Some 130 policemen were wounded, several seriously.

Hot foot from his visit to China, Mr Sarkozy set a hardline tone. After visiting in hospital a police chief wounded during the first night of violence, he vowed that anybody who fired at the police would end up in a criminal court, calling it “attempted murder”. In 2005 rioters wielded only petrol bombs and stones; this time many policemen were hit by gunshots. An official report before the riots noted a rise in attacks on policemen in the *banlieues*.

Local (mainly Socialist) mayors have been giving warning for a while that, two years on, tensions remain high. Not that these grim neighbourhoods have been neglected. They have had a huge injection of public cash, primarily for the renovation of the housing projects that ring the big cities. Tower blocks have been demolished, streets have been relaid and lighting has been improved.

Mr Sarkozy, who was demonised in the *banlieues* during the election campaign for his harsh anti-immigrant stance, appointed a left-wing Muslim woman, Fadela Amara, as a minister to deal with the inner cities. Her “Marshall plan” for the *banlieues* is due in January. By including her, as well as others from ethnic minorities, in government, he sent a message of inclusion to the heavily Muslim suburbs.

Even so, the two biggest problems in these neighbourhoods remain. The first is the failure of the French economy to create enough jobs. Unemployment in what officialdom coyly calls “sensitive urban areas” is twice the national average; on the worst estates, it can hit 40%. Mr Sarkozy wants to loosen the labour market to encourage job creation, but negotiations with unions are still in progress.

The second is the tense relationship between the police and local youths. France is hamstrung by a sterile debate between left and right over policing. The left insists that things have deteriorated since neighbourhood policing was dismantled, and blames the right for its more heavy-handed approach. Mr Sarkozy insists that earlier methods were too lax, treating policemen like social workers not law-enforcement officers. He prefers a strong hand to clamp down on criminality.

These riots have come at a testing time for Mr Sarkozy's six-month-old presidency. He has just endured a nine-day public-transport strike against pension reform, which brought chaos to the roads and enraged commuters. Another one-day strike is planned on December 18th. Students have blockaded university campuses for weeks in protest at higher-education reform. Magistrates staged a one-day strike this week against judicial reform.

There is no suggestion that the two protests—one planned and union-based, the other spontaneous—are linked. And public opinion is firmly on Mr Sarkozy's side in both. But war on two fronts is always testing. It is one thing to deal with organised and peaceful discontent on the streets. The criminal violence that broke out this week is far less predictable.

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The independence precedent

# If Kosovo goes free

Nov 29th 2007 | SUKHUMI AND TSKHINVALI
From The Economist print edition

**Why Georgia's enclaves would love to follow, but will probably fail**

KOSOVO Albanians and Serbs met in Austria this week for last-chance talks before a United Nations deadline of December 10th, after which Kosovo is likely to declare independence unilaterally. Serbia's old ally, Russia, blocks any UN resolution. But plenty are watching south of Russia in the enclaves of Georgia. As Maxim Gunjia, the cheery young deputy foreign minister of Abkhazia, says, “because Russia does not want Kosovo to be recognised, it does not mean that we do not want it.”

When the Soviet Union and Yugoslavia fell apart, sovereignty passed to their constituent republics. But Kosovo was a province of Serbia. Its independence, argues those worried by precedents, will be seized on by separatists from Catalonia to Chechnya (to say nothing, nearer home, of the Bosnian Serb republic). As Russia's Vladimir Putin once asked, “If people believe that Kosovo can be granted full independence, why then should we deny it to Abkhazia and South Ossetia?”

Why indeed, ask people in these two enclaves, which are among the four “frozen conflicts” left from the wreckage of the Soviet Union. The enclaves broke away from Georgia in nasty wars in the early 1990s, but no country recognises their independence. Two other frozen conflicts are in Transdniestria, which split from Moldova, and Nagorno-Karabakh (see article). Recently the presidents of three of these Russian-backed places met in Sukhumi, Abkhazia's capital.

Abkhazia is a backwater, much of it in ruins. In contrast to the Balkans, it has received no international largesse. This would change, argues Mr Gunjia, if the world would only recognise Abkhazia. That is unlikely. Western countries are wedded to the territorial integrity of Georgia; so, despite its support for the secessionists, is Russia. Leyla Taniya, an analyst, sighs that Russia cares for Abkhazia only “as a card that can be played” directly against Georgia or in the great game with the West over the region's future.

“Those rules which work for Kosovo will work for South Ossetia,” insists Alan Pliev, South Ossetia's deputy foreign minister, in Tskhinvali, the capital. But the situation in each place is different. Kosovo has 2m people, 90% of them ethnic Albanians, who have long been in the majority. Only 200,000 people live in Abkhazia. Before the war in the early 1990s only 18% of them were Abkhaz; even today they make up no more than 45% of the people, the rest being Armenians, Russians and Georgians. More than 200,000 Georgians from Abkhazia are refugees in Georgia who are unlikely to be allowed to return.

Georgians accuse the Abkhaz of ethnic cleansing. The Abkhaz say they have reclaimed what was lost by deportations to Turkey in the 19th century and to Siberia in the 20th century, as well as through later Georgian settlement (Stalin was Georgian). Today Russia supports the Abkhaz and South Ossetians with money, troops and passports. Both places use the rouble; Russian money is flowing in, especially to Abkhazia. The Russian passports let locals travel, but may also allow Russia to claim its citizens have been attacked if Georgia tries to retake the enclaves.

Yet even if Kosovo declares independence, Russian recognition is unlikely. It might, says Inal Pliev, a journalist in Tskhinvali, be Russia's “holy duty”, but reality intrudes. South Ossetia is a tiny patchwork with perhaps as few as 50,000 inhabitants in the Ossetian-controlled part. Much of the land is controlled by Georgians. It is linked to Russia by a tunnel through the mountains; on the other side is the autonomous Russian republic of North Ossetia.

“Our aim is unification with North Ossetia,” says Alan Pliev. “We don't know if that would be as part of Russia or as a separate united Ossetian state.” The deputy speaker of parliament, Juri Dzittsojty, is cautious. “I would prefer there to be an independent and united Ossetia, but today it is not possible. It is safer to be with Russia. The main aim of the struggle is to be independent of Georgia.”

And tomorrow? If Russia recognised the enclaves, that might encourage bits of Russia that wanted independence. This is why Russia is unlikely to act even if Kosovo is widely recognised. Yet the Georgians are nervous. David Bakradze, the state minister for conflict resolution, says he is not worried about Kosovo, but about “the misuse of Kosovo”.

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Nagorno-Karabakh

# The risk of a thaw

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**Another dangerous conflict zone in the Caucasus**

IT MAY be the most combustible place in Europe. Were it to reignite, the effects could be dire. Yet the world takes little interest in Nagorno-Karabakh, a mountainous enclave disputed by Armenians and Azerbaijanis, preferring to see it as just another “frozen conflict”. The fear is that it may be thawing.

A war that killed 25,000 people ended in a ceasefire in 1994, leaving Armenians in possession of the province (which already had an Armenian majority in Soviet times, but was part of Azerbaijan), plus a long ribbon of Azerbaijani territory that the Armenians treat as a “buffer zone”. The trenches across the ceasefire line have moved closer, and shots are often exchanged; 30 soldiers have been killed this year. There are no peacekeepers, only a tiny unarmed group of international observers. Even they are no longer monitoring the ceasefire after a diplomatic dispute.

Suspicions in both countries have stymied any peace talks. Both are expanding defence spending. Oil-rich Azerbaijan takes in as much as $20 billion a year in oil revenues. President Ilham Aliev has promised that his military budget, now $1 billion a year, will overtake Armenia's total public spending. On October 30th he said, “We should be ready at any moment to liberate the occupied territories by military means.”

A meeting of the two countries' foreign ministers this week offered only a fading chance for an agreement on a framework peace deal. The hope had been that the two presidents might accept a statement of basic principles that postpones final decisions on sovereignty, while Armenians withdraw from occupied territory and the borders reopen. Unfortunately both countries face presidential elections next year, so their political leaders prefer not to risk accusations of making deals with the enemy.

A full-blown war may still be unlikely in the immediate future. But as a recent report from the Brussels-based International Crisis Group, “Risking War”, points out, the most dangerous moment may come in 2012, when Azerbaijani oil revenues start falling and Mr Aliev's government may feel the country's military edge over Armenia is at its greatest.

Nagorno-Karabakh sits in a strategically vital region, surrounded by Georgia, Russia, Iran and Turkey. The Baku-Tbilisi-Ceyhan oil pipeline runs close to the ceasefire line. It would be easy for even a small clash to get out of hand. An official who has dealt with the dispute for years quotes Anton Chekhov's maxim that, if a gun is hanging on the wall in the first act, it will always go off by the play's end.

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German foreign policy

# The company she keeps

Nov 29th 2007 | BERLIN
From The Economist print edition

**Why Chancellor Angela Merkel is having a spat with her foreign minister**

Reuters

**Steinmeier waits, Merkel cooks**

"AS CHANCELLOR, I decide whom I will meet and where." Angela Merkel aimed this salvo not at a foreign potentate but at Frank-Walter Steinmeier, her deputy and foreign minister. Ms Merkel was defending her recent meeting with the Dalai Lama, which Mr Steinmeier had denounced as "display-window politics" that needlessly strained Germany's relations with China. Behind this row lies a bigger one: how to respond to the rising power of China and Russia.

Tensions between the chancellor and the foreign minister, usually from the smaller coalition party, are not unheard-of. Gerhard Schröder, Ms Merkel's predecessor, said his Social Democratic Party (SPD) was the "cook", while the Greens (whose Joschka Fischer was foreign minister) were "waiters". In 2005 Ms Merkel's Christian Democratic Union (CDU) became chef and the SPD took up the trays. A "grand coalition" has built-in tensions. Mr Steinmeier, once Mr Schröder's chief of staff, is a possible challenger to Ms Merkel in the next election. "You can win or lose votes because of your China policy," notes Sebastian Bersick of the German Institute for International and Security Affairs. But four-fifths of Germans approve of Ms Merkel's meeting with the Dalai Lama.

The bigger recent changes have been far beyond Germany. High energy prices have given Russia back some of the swagger it lost when the Soviet Union collapsed. In trouble-spots from Darfur to Iran, China now matters. "There is no issue where China is not part of the problem and the solution," notes Eberhard Sandschneider of the German Council on Foreign Relations.

Ms Merkel and Mr Steinmeier differ in their conclusions from this. The foreign minister, schooled in the SPD's tradition of *Ostpolitik* (the cold war opening to the east) prefers to make the case for human rights behind the scenes. Mr Schröder dallied with China and now works for Gazprom, Russia's energy giant. For Ms Merkel, China and Russia are competitors as well as partners: co-operation does not preclude criticism. A recent CDU strategy paper on Asia notes that China is "offering an alternative political order which challenges the economic and political interests of Germany and the EU outside Europe."

Ms Merkel probably agrees with this. On taking office she helped scotch a European move (backed by Mr Schröder and France's Jacques Chirac) to lift an arms embargo against China. Her efforts to repair relations with the United States, frayed by Mr Schröder's opposition to the Iraq war, are in part a response to the rise of authoritarian powers. Europe and America, Ms Merkel believes, should present a united front. That fits with the EU's new, tougher approach towards China (see article). A child of East Germany, Ms Merkel understands captivity and has lectured the Americans on Guantánamo Bay as well as Russia and China on freedom.

After her meeting with the Dalai Lama, the Chinese cancelled a visit by Germany's finance minister, and suspended a dialogue on legal systems. Other leaders, including George Bush and Canada's Stephen Harper, have met the Dalai Lama yet provoked a milder reaction. But China considers Germany an especially close friend, claims Friedolin Strack of the Federation of German Industries, so its disappointment is sharper. Or perhaps China is aware of the tensions inside the grand coalition and is exploiting them.

So far it has not done any more. Few contracts are at risk of cancellation. The multinational sprawl of big companies makes it hard to discriminate against Germany. France's Nicolas Sarkozy surprisingly did not take his human-rights adviser on his visit to China this week. But the two biggest deals he signed—involving Airbus, an aerospace firm, and Areva, a producer of nuclear power plants—were with companies

part-owned by Germans.

China's sour reaction is “partly tactical”, says Mr Bersick. It would like Germans to choose between friendship and candour. Better still would be to drive a wedge between Europe and America. “Germany should not fall into that trap,” says Mr Bersick. Ms Merkel's meeting with the Dalai Lama suggests she will not. The partnership with China should endure. On November 26th the two countries signed a food-security accord, a sign, perhaps, that the freeze is already ending.

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Charlemagne

# The Polish farewell

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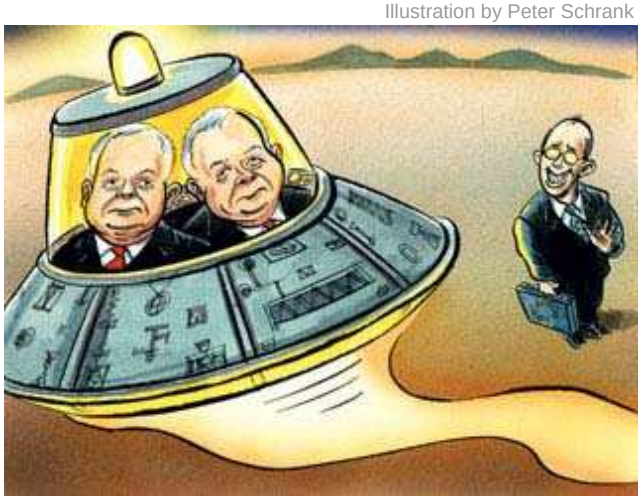
Illustration by Peter Schrank



**Manners may change, but it is national interests that still shape the inner life of the European Union**

CRASS, amateurish and deplorably nationalistic. That is how the Brussels elite sums up the Polish government that has just left office. To many, the nationalistic label was the worst jibe of all. Ask Euro-types for a memory of the twins who ran the government, Lech and Jaroslaw Kaczynski, and they are likely to recall the time when Jaroslaw, as prime minister, unsuccessfully demanded voting rights for his war dead. (Without the second world war, Mr Kaczynski argued in June, Poland would today have an extra 28m people, so should be given the votes of a bigger country.) This nationalistic sally broke all the rules of European Union behaviour, which dictate that the war may be cited only to highlight the miracle of post-war reconciliation.

Yet when it comes to Poland's recent failures in Brussels, crass and amateurish are the epithets that matter more. The twins were never as anti-European as their rhetoric suggested. Perched on the edge of Europe near Russia, they backed things that give Eurosceptic nations, such as Britain, the shivers, for example a stronger defence role for Europe. The Kaczynski government contributed troops to an EU mission in the Congo, and promised to send more to an EU operation in Chad. Poland supports both a common EU defence policy and a strong NATO. If you live near a “forest full of bandits”, it is best to have two locks on the door, explains Bronislaw Komorowski, the new speaker of parliament.

Charlemagne would choose a more obscure confrontation as his memory of the outgoing Polish government. It was in September, when Poland blocked a “European day against the death penalty”, saying it preferred to celebrate the broader “right to life”. This was a pretty meaningless spat. The death penalty is banned throughout the EU, and is not coming back. And it is no secret that the Kaczynski twins adhere to Roman Catholic teachings on abortion and euthanasia—as do many Polish voters. But it was what came next that stunned those present. Poland's junior justice minister, Andrzej Duda, reopened the argument at a working lunch. As ministers ate, Mr Duda turned to the Danish justice minister, Lene Espersen, and read out the number of abortions carried out in her country.

This moment merits pondering. It was too private an incident to impress voters back in Poland. Mr Duda's attack was never going to affect abortions in Denmark, nor in the EU, which has no policy role. What it did was to disgust Mr Duda's fellow ministers and offend the Danish government, which was not only a firm supporter of Polish accession in 2004, but also a potential ally in the argument between northern Europeans over the NordStream gas pipeline that Russia and Germany plan under the Baltic. And it is just this sort of self-defeating weirdness that most tarnished the outgoing government's EU credentials. In another example, the twins insisted that the Charter of Fundamental Rights tucked into the new Lisbon treaty might impose gay marriage on Poland. No other government, institution or legal adviser agreed.

The new prime minister, Donald Tusk, even says he might sign the charter one day (though President Lech Kaczynski is blocking him for now).

This offers one piece of good news. Mr Tusk's government can achieve much just by being less weird. This is understood in Warsaw. Mr Komorowski wants Europeans to know that Polish voters have chosen “normality and moderation”. The new foreign minister, Radek Sikorski, says Poland is “retaking its place in the mainstream of European politics”. As a first step, that means talking to the neighbours, starting with Germany and Russia. Mr Tusk has made Wladyslaw Bartoszewski, an 85-year-old veteran of the wartime resistance, an Auschwitz survivor and former foreign minister with close ties to Germany and Israel, his “minister for difficult issues”, advising on foreign affairs.

## Events, events

The passage of time offers a second piece of good news for Polish-EU relations. For a while it mattered a lot that Poland differs from many other European countries when it comes to dealing with America and Russia. Poland was quick to support the American invasion of Iraq. It was ready to confront Russia, triggering complaints that a newcomer was wrecking the EU's friendly relations with a rising energy giant. Poland is still blocking any work on a new EU-Russia accord in protest against a Russian ban on Polish meat exports.

But the world is changing. Today's America is not as venturesome: Mr Tusk has said Polish troops will leave Iraq in 2008. America is now in less of a rush for Poland to host its anti-missile interceptors. Ever fewer European leaders see Vladimir Putin's Russia as a potential friend.

Yet Poland is not ditching its national interests. Nobody in Warsaw predicts the Polish veto on EU-Russia talks will be lifted quickly. And next year will see two big rows in Brussels. Poland is not going to lie down during either of them.

The first will come when countries haggle over “burden-sharing” on greenhouse-gas targets for 2020. Carbon emissions must fall dramatically, and renewable energy use must soar. Yet most Polish officials sound keener on catching up with the wealthy West than fretting about the climate. The new economy minister, Waldemar Pawlak, who heads the Peasants' Party, Mr Tusk's coalition partner, has called Poland's coal reserves an “attractive” source of energy.

The second row will be about next year's review of the EU's common agricultural policy. The Peasants' Party will lead negotiations for Poland, and, as its name suggests, will fiercely defend direct EU payments to Poland's 1.4m farmers.

So what will change with the new government? Is it just that Polish national interests will be pursued under the cover of warm and friendly Euro-speak? After the twins' crass eccentricities, Brussels would settle for that. In diplomacy, Mr Sikorksi murmurs, “style makes a difference”. In Europe, too.

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Labour's latest scandal

# When the money machine blows up

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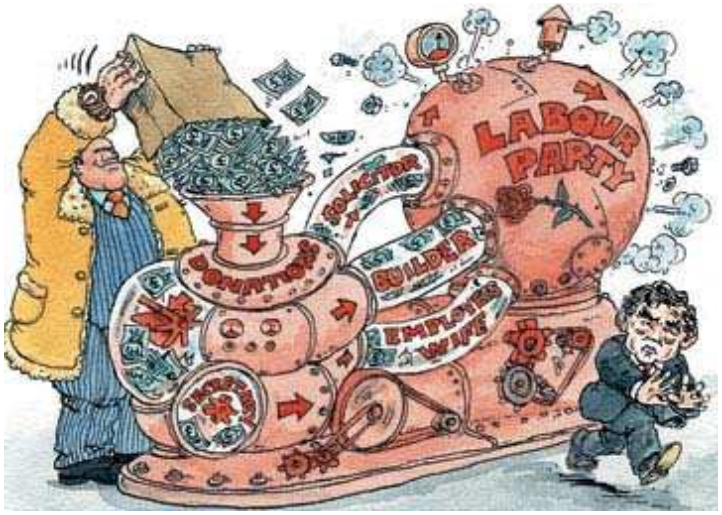
Illustration by David Simonds




**Gordon Brown struggles to keep his footing as another crisis erupts**

Gordon Brown

TONY BLAIR, after years as Britain's prime minister, remarked recently that religion and politics don't mix: a leader who invokes his faith is, he lamented, considered a “nutter”. For his successor, Gordon Brown, reconciling politics and God must seem a breeze compared with reconciling politics and money. Less than two months after the police dropped investigations into whether parties had offered peerages in exchange for loans, another money scandal is gripping Westminster.

The latest is a labyrinthine affair, and potentially devastating for Mr Brown. Since 2003 David Abrahams, a property developer from the north-east, has donated a total of over £650,000 ($1.3m) to the Labour Party through intermediaries including two employees, the wife of another and his solicitor. He claims to have done this to protect his privacy but, under the tighter rules introduced by this government, making donations in someone else's name is unlawful. On November 26th Peter Watt, the general secretary of the Labour Party, admitted that he knew about the arrangement, and resigned. Mr Brown, who claims not to have known, has promised to return the money.

Unfortunately for Labour, the mess does not stop there. On November 27th it emerged that Jon Mendelsohn, the party's chief fundraiser and recruited in September by Mr Brown himself, knew of Mr Abrahams's indirect donations too, although he was unhappy about them.

Questions have also arisen about contributions during the contest for Labour's deputy leadership last summer. Janet Kidd, Mr Abrahams's secretary, gave £5,000 to Hilary Benn, one of the candidates, who returned it after being tipped off that Mr Abrahams was the real source of the money. Mr Benn then took the same sum from Mr Abrahams directly. But Harriet Harman, the winning candidate, did accept a £5,000 donation from Ms Kidd, apparently without realising its true provenance. The spectacle of a donor giving money to different candidates under different names is odd enough; many wonder how Ms Harman could not have known what Mr Benn knew. The question is acute as she is married to Labour's treasurer, Jack Dromey, who says that he too was out of the loop. She is returning the money but Mr Brown's support for her has so far been nuanced.

Others are being dragged in too. In 2006 the Highways Agency lifted its block on a planning application for a new commercial centre in the north-east to be built by associates of Mr Abrahams. The government denies that ministers played any role in the decision, but promises to investigate the matter.

Party-finance rows are not confined to the Labour Party: the Conservatives received more money in undeclared loans before the last general election than Labour did, and the Liberal Democrats took money from a convicted perjurer. Indeed, it is due in part to Labour's efforts to make the system more transparent that chicanery is now evident. But whatever the context, a law has been broken. The Electoral Commission is investigating further and has consulted the Crown Prosecution Service. A police investigation may follow.

The funding fiasco has hit a prime minister who was already short of political capital. Mr Brown's honeymoon with the electorate was at its dreamiest during the Labour Party conference in September. Since then he has endured the botched handling of a possible snap election, the messy rescue of Northern Rock, a mortgage lender, and the loss by the customs and revenue office of 25m people's personal data. His reputation for competence has suffered horribly; he cannot now afford to lose his reputation for probity.

## A Major legacy

Mr Brown is often likened to William Gladstone for his intellect and compares himself to Margaret Thatcher as a conviction politician. The analogy that commentators now draw with Sir John Major, the most recent Tory prime minister, will hurt. Mr Brown's premiership is not yet doomed, as Sir John's was, to be a fire-fighting postscript to that of a more illustrious predecessor. Sir John suffered a steady trickle of bad news over several years; Mr Brown has had a concentrated deluge of disasters, and the weather may improve as suddenly as it worsened. Unlike Sir John, he leads a stable government with a comfortable majority in Parliament. And whereas Sir John's opposition turned his woes into unassailable poll leads, the Tories have not yet definitively raced over the horizon.

Yet in other ways Mr Brown's fate may be worse than Sir John's. The latter at least won an election (and by a good margin in the popular vote, though not in parliamentary seats). Ever fewer pundits believe Mr Brown will do the same. And Sir John left a tangible legacy. The economic expansion that continues to this day began under him, as did the fall in crime. He introduced market reforms into the public sector, and even his policy towards the European Union (remaining outside the euro but sufficiently involved to push for eastward expansion) has been broadly vindicated.

By contrast, it is hard to know how Britain will be different after Mr Brown's time in office, though this is partly because he has already served a decade as chancellor of the exchequer. He harbours a few big ideas, such as extending the school-leaving age to 18, but seems disappointingly keen on diluting Mr Blair's promising public-service reforms. A sense of direction enables governments to stay on their feet when times are tough. Mr Brown must acquire one if his premiership is to recover.

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Virgin and Northern Rock

# Shotgun wedding

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**One suitor has been chosen, but others are forcing their way into the church**

AT FIRST it proceeded at a glacial pace, but the sale of Northern Rock has now picked up unseemly haste. On November 25th Richard Branson's Virgin Group was chosen as preferred bidder for the stricken bank, which is kept alive only by public money. The Sunday decision caught many by surprise, not least rival bidders who were either due to present their bids to the bank and the government in coming days, or had done so that weekend and had no inkling that things would move so fast.

Such haste at this late stage is unlikely to serve the interest of taxpayers, who have lent over £20 billion ($41 billion) to the mortgage lender since it came cap in hand to the Bank of England in September. That was the time for urgent action, and Alistair Darling, the chancellor of the exchequer, could have moved far faster to sort out the mess.

Instead he allowed the wretched affair to drag on. The delay has strengthened the hand of investors, including some hedge funds that have been busily extending their stakes. They are now threatening to veto any takeover that they reckon undervalues the bank—an audacious proposition considering that Northern Rock would have folded but for the support of the public purse.

Bryan Sanderson, the newly-appointed chairman of Northern Rock, says Virgin was chosen because it offered something to all “stakeholders”—which sounds rather worrying. Sir Richard has proposed putting £200m of his own money together with Virgin Money, his financial-services business, into Northern Rock. Half of the £1.3 billion of cash he proposes to raise would come from current shareholders through a deeply discounted new rights issue. He also promised to pay off £11 billion of the central bank's loan immediately, and the rest within three years.

Purely on its own merits, the bargain is a poor one for taxpayers, for their risk is barely diminished: as all bankers know, it is not the first but the last pound of a loan that is hard to get back. Even if the government gets a commercial interest rate, it is still assuming a risk that the private sector is patently shunning. When judged against competing bids, the deal looks even worse. A rival proposal from J.C. Flowers, an American private-equity firm, for example, promised to repay more of the Bank of England's loan at once.

The sudden rush to advance Virgin's case is ill-advised, however tempting the political arguments might be for getting Northern Rock off the front pages. If taxpayers are to take their chances on a private-sector rescue, a proper auction makes more sense than a shotgun wedding. A threat by big investors to reject Virgin's offer is now forcing the government and Northern Rock's board to think again. Several bidders are battering at the church doors with offers that may prove better value for shareholders and taxpayers alike. They should be let in.

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Politics and business

# If firms had the vote

Nov 29th 2007
From The Economist print edition

**New Labour is losing the support of business, and it matters**

ONLY in the City of London, where banks, shops and other employers choose the corporation that oversees the “square mile”, can business say that taxation is truly based on representation. Elsewhere it has to hope the citizenry elects governments that are firm-friendly, and will resist the urge to nationalise, meddle or tax companies too much. But if business could vote, whom would it support?

Surprisingly, as the party at least pretended to champion socialism until the early 1990s, the answer for most of the past decade would have been Labour. But that is now changing, and Gordon Brown, the prime minister, is fast discovering just how fickle businesspeople can be. They are trickling back to the Conservative Party, in earlier times their natural ally.

This week, at the annual conference of the main business lobbying group, the CBI, the list of complaints was long, taking in red tape (too tangled), roads and airports (too congested) and taxes (too high). This much is standard: the CBI has members to recruit and dues to collect. Nor are such complaints made only against Labour governments. In 1980 the CBI chairman of the day threatened a “bare-knuckled fight” with Margaret Thatcher's government over interest rates and the price of sterling.

But this year's conference was more sharply party-political than usual. Martin Broughton, chairman of British Airways and president of the CBI, not only criticised Mr Brown's policies and record but also praised David Cameron, the Conservative leader, for creating a strong “electable opposition” with views on business that are “well in synch with ours”.

Such words are heard with increasing frequency in British boardrooms these days. Many directors of top companies privately express their growing frustration with the government. Other business organisations, such as the Institute of Directors and British Chambers of Commerce, are also stepping up their attacks. Sensitive to shifting currents are the policy wonks at CEBR, an economic consultancy, who put out a paper this week that was catchily called “We need to start considering what a Tory Government might do”.

The strongest sign yet of a shift in sentiment is that even long-time business friends and supporters of Mr Brown and his party have become more openly critical. Some have shown a startling enthusiasm for change. Among them is Sir Ronald Cohen, a doyen of Britain's private-equity industry and long-time donor to the Labour Party. He said recently in a newspaper interview that there was “not much difference between the two parties” and that he would not mind if a Conservative government came to power.

Why this shift, and why now? Cynics say it simply reflects the parties' changing fortunes. The Tories have not seen the inside of Downing Street since 1997; practicality counselled firms to back the winning horse. Now that political power is being seriously contested again, business may simply be placing its next bet.

But there is more to it than that. Even before New Labour took office, it was busily buffing its pro-business credentials. Once in power the party both embraced the market and set the central bank free from politicians to set interest rates. Whether by skill or good fortune, Labour presided over a decade of low inflation, low interest rates and sustained economic growth. This was one of the main reasons for the party's electoral longevity.

## The drift away

Three things explain why business support is draining away from Labour. First, its reputation for sound economic management has been damaged by its bungled handling of Northern Rock, a troubled mortgage lender, and by concerns about the slowing economy and housing market. Second, businesspeople suspect Labour has grown arrogant in power and no longer feels obliged to keep its side of the bargain struck a

decade ago, especially with that friend of the rich, Tony Blair, out of the picture. Third, there is a growing sense of outrage at the vast sums the government has spent on the public sector to less than optimal effect, while the wealth-creating side of the economy has been weighed down with regulations and tax.

Take the high-handed decision announced in October to raise capital-gains taxes to a flat 18% from an effective 10% on most business assets. Aimed at capturing some of the gains made by partners in private-equity firms, it is widely seen as an attack on small business. “The damage is in the signal it sends, which is that this is an economy that doesn't value entrepreneurs,” says Arnaud de Meyer of the Judge Business School at Cambridge University.

Taxing small businesspeople, who are mainly steadfast Tories, is unlikely to cost Mr Brown many votes. But John Curtice of Strathclyde University reckons public confidence in Labour as the party most trusted to run the economy, already declining, is likely to ebb faster as businesspeople air their doubts. A recent Populus poll shows the Tories well ahead on this point. Although business has no vote, in forfeiting its support, Mr Brown may well be scuppering his chances of re-election.

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**Freedom of speech**

# Invite and insult

Nov 29th 2007 | OXFORD
From The Economist print edition

**A tussle at the Oxford Union ends in a creditable draw**

IT WASN'T hard to distinguish the men of the right-wing British National Party (BNP) from the members of the Oxford Union debating society on November 26th. The students who came to hear Nick Griffin, the BNP's leader, speak alongside the Nazi apologist David Irving were mostly fey public-schoolboy types with plummy voices and the odd corduroy jacket, plus some fashionable young women. The BNP goons, for their part, wore standard-issue crypto-fascist leather coats and unnecessary black ski hats, except for one who sported a neo-tsarist beard.

The students and other protesters who gathered outside the Oxford Union building to try to prevent Mr Griffin and Mr Irving from speaking were rather rowdier. The chanting, intermittently rapping crowd had a case. Their chequered pasts—Mr Griffin was convicted in 1998 of incitement to racial hatred; Mr Irving was imprisoned in Austria for denying the Holocaust—do not obviously make the men experts on the limits of free speech, the subject of the debate; they are entitled to their opinions, but not to a privileged platform for them at Oxford. Nor do they represent large constituencies or hold high office as does, say, Mahmoud Ahmadinejad, Iran's president, who spoke at Columbia University in September.

AFP

**Rumble at the Union**

On balance, however, the Oxford Union members who had voted to stage the debate had a better case. Free speech, they argued, is like a muscle which needs to be exercised to remain useful; the extremes of its terrain must be staked out to stop it shrinking. That seems a better attitude than Austria's, which by imprisoning Mr Irving boosted his notoriety (and his appeal to the Oxford Union). It is also preferable to that of the British government, which pursues the impossible goal of protecting the feelings of Muslims, gays and other groups who officially loathe each other.

In the end, both sides made their point. Protesters managed to climb the railings and break into the debating chamber to stage a sit-in. (“Wagner, perhaps?” shouted a young man as he commandeered a piano.) They scarpered when the police got involved. Introducing Mr Irving, the president of the Union described his views as “despicable and abhorrent”, adopting Columbia's “invite and insult” approach.

So the Union honoured its avowed commitment to free speech (Harold Macmillan once described it, with perhaps a little hyperbole, as “the last bastion of free speech in the Western world”). It also, of course, generated the sort of controversy that is another part of its historic mission—witness the infamous 1933 debate on a motion that “This House will under no circumstances fight for King and Country”, and a more recent invitation to O.J. Simpson. The only people to emerge with little or no credit from the occasion were the chaotic police, Mr Irving and Mr Griffin.

Mr Irving was savvy enough to be polite about Jews and ingratiatingly grateful to his hosts, but he came across as a broken, paranoid man. As for Mr Griffin—regurgitating bile, flanked by his beefy bodyguards for protection—he looked no more than a nasty clown.

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Private schools

# Feeling uncharitable

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From The Economist print edition

**Some schools may have to make a profit if they want to remain independent**

MANY of Britain's best-known private schools—now famous both for their illustrious alumni and their eyewatering fees—were founded to educate poor children. Just what should be done to narrow this gulf between charitable purpose and exclusive practice has long exercised minds on both sides of the political divide. Some left-wingers would like all private schools closed; free-market adherents, by contrast, would like them opened up with state-funded scholarships for the brightest, or even a full-blooded voucher scheme.

The government has chosen a third way, altering the regulations governing charities so that schools will have to demonstrate that they provide "public benefit". Guidance on how they can do this will be published in 2008, and it will be at least 2010 until it becomes clear whether the new regime has bite. But already the Charity Commission has said that offering a few bursaries and sharing playing fields with state schools is unlikely to be enough.

Cognita

**No longer an object of charity**

Schools have to heed such hints because it is almost impossible to shed their charitable status, even if they are willing to forego the attendant tax breaks. The commission can "remove trustees and freeze bank accounts" if a school refuses to co-operate, one of its executive directors told the *Financial Times* in September, adding ominously, "We can go nuclear if we have to." The "politics of envy" is alive and well, was the prompt response from Bernard Trafford, chairman of the headmasters' conference, which represents 250 of Britain's most exclusive schools. "People just want to have a go with any weapon they can," he told a conference in October. "The public-benefit debate is the latest one."

Private schools should take a look at the government's academies programme, said Andrew Adonis, a junior education minister, at the same conference—which some took as a broad hint, even though the charities regulator is independent from government. Some are indeed sponsoring academies, and a few have even become (state-funded) academies themselves, abandoning academic selection.

Now another option is being touted by one of British education's most provocative figures: Chris Woodhead, former chief inspector of schools, scourge of progressive teachers—and, since 2004, chairman of Cognita, a company backed by private equity that buys independent schools and uses economies of scale to squeeze out costs. A charitable school could sell itself—to Cognita, naturally—with the money going to the school's trust (the legal entity that owns the charity's assets), which would fund bursaries for its pupils. The school would be run for profit, and only the trust would come under the charity regulator's thumb. The lost tax breaks would equal only a small share of fees.

This is attractive to Cognita, which could then buy a school with a ready-made pot out of which some customers' fees could be paid—and plenty of room for expansion. To the trustees of schools that are fighting now to stay afloat, it may offer a lifeline. And some schools might relish the freedom of the profit-maker to concentrate on satisfying customers.

Cognita has already bought five once-charitable schools, and the Charity Commission has not complained. All had been struggling, so the prices paid were not high enough to fund many bursaries. But Cognita is now in talks with some very successful schools, says Mr Woodhead—although he refuses to identify them.

"Clever, isn't it?" exclaims Mr Trafford, when the scheme is explained to him. Some schools, he thinks,

that have recently abandoned independence for state funding might have found this an attractive alternative, had they known about it.

Not all, though. “We see huge advantages both for us and our parents in us delivering as a charity, not least that every penny of income benefits our schools and pupils,” says a spokesman for the Girls' Day School Trust, which is converting two of its 29 schools into state-funded academies. Demonstrating public benefit holds no fears for the trust, she says: it was already working with state schools, and offers bursaries and scholarships.

And some will not be able to take up this offer, even if they want to—for example, if their trusts have been set up in such a way that they must provide education, not just pay for it. Yet even those who can't—or don't want to—open an escape hatch may be glad it exists. “The more we have alternatives,” says Mr Trafford, “the less people can hold guns to our heads.”

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Road pricing

# Wrong way

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From The Economist print edition

**Roads are clogging up, as government retreats from the obvious solution**

MARGARET THATCHER was a great fan of the motorcar, speaking approvingly of “a great car-owning democracy”. She would no doubt be pleased to note that today only 25% of Britain's households have no access to a car, compared with 41% when she came to power. Yet car ownership remains low by international standards. One reason may be the state of the country's roads, which are among the most congested in Europe—and set to get worse.

On November 28th the RAC Foundation, a motoring lobby group, released a forecast of traffic growth. Using assumptions similar to those of an official study carried out last year by Sir Rod Eddington, an ex-boss of British Airways, it predicts that a combination of economic and population growth will lead to a 37% increase in demand for road space by 2041. As road-building rates have declined steadily over the past two decades, that does not bode well.

Until recently there was consensus about what should be done. Having abandoned a green-inspired policy of opposing almost all new road schemes in its first few years in power, the government now plans a modest programme of road-building. But it also accepts the argument, long advanced by academics and environmentalists, that simply building more roads is not enough. In 2004 Alistair Darling, then Tony Blair's transport secretary, floated the idea of a national road-pricing scheme designed to address the demand for road space as well as the supply of it.

A pricing system would solve the biggest problem faced by motorists: the lack of a proper way to allocate capacity. The current tax system penalises more polluting cars, and those that consume more fuel. But congestion costs go unpaid. In the absence of charging for road space, capacity is rationed instead by delays and queues. And whereas congestion is concentrated in urban areas and along big trunk roads, the burden of road tax is spread equally (and unfairly) across both rural and urban drivers.

Yet despite its appeal to economists, the idea of road-pricing has languished. A scheme for lorries, due to arrive in 2008 and seen by many as a precursor to a broader national scheme, was scrapped before it could be implemented. Under Gordon Brown, the neglect has worsened. A recent transport-policy document was careful to make no references to a national road-pricing scheme. Ruth Kelly, Mr Brown's transport secretary, admitted in a webchat in September that there were “no current plans” for national pricing. Many observers believe that the policy is being left to die quietly.

This is largely because motorists seem to prefer queuing for road space to the idea of paying for it. Road pricing has been consistently unpopular. The turning point came in February, when a petition opposing the notion hosted on the Downing Street website attracted 1.8m signatures, six times more than on any other subject.

Yet road pricing need not be a political death sentence. Ken Livingstone, London's mayor, was re-elected after introducing a congestion charge to the capital in 2003. The RAC report advocates an eminently sellable scheme whereby fuel duty (at around 50p a litre, among the highest in Europe) is abolished and replaced with a 14p carbon charge. Motorists would then pay per kilometre according to how busy the road was. City drivers (currently subsidised by their rural counterparts) would pay more, while country drivers—or those who avoid the rush hour—would pay less.

Part of the reason for the opposition, says Stephen Glaister, a professor at London's Imperial College who contributed to the RAC report, is the government's clumsy presentation of its case. In London Mr Livingstone sweetened the pill by promising to spend the revenues on better public transport. But the Treasury's reluctance to earmark specific taxes for specific purposes prevents ministers from making a similar bargain.

In the absence of both road pricing and a serious programme of road building, it is not clear how ministers

plan to unclog the roads. There is vague talk of encouraging frustrated motorists to use the railways, but there is little spare capacity on the trains either. Overcrowding is already bad on many routes, especially commuter lines into London. Rail experts worry that the London-to-Glasgow West Coast Main Line—in which £8.6 billion is now being invested to increase capacity—could be jammed again by 2015. And though using price to control demand on the roads seems to be out of favour, the railways are embracing it enthusiastically: fares are due to rise by up to 14% next year.

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Liberal Democrat leaders

# The final straight

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**The third party gets down to choosing its third leader in two years**

THE race for the leadership of the Liberal Democrats, which began when Sir Menzies Campbell resigned in October, has not been gripping. Indeed, the impressive performance of Vincent Cable, their caretaker, has garnered as much attention, with polls suggesting that the party has gained more than the Tories from Labour's continuing travails.

But the Lib Dems will prefer the uneventful showdown between Nick Clegg, their home-affairs spokesman, and Chris Huhne, who holds the environment brief, to the intrigue and scandal that marred their previous election in 2006. On November 21st ballot papers were sent out to the party's 64,000 members, who have until December 15th to vote. The result is expected two days later.

PA

**Huhne and Clegg: rivals and friends**

Though Lib Dems downplay the ideological divide in their party, it remains a coalition of classical liberals (led by the MPs who penned the free-market Orange Book in 2004) and social democrats (more numerous among the base). Their name—a compound of the old Liberal Party and the short-lived Social Democratic Party—reflects this. And if Mr Clegg, an Orange Booker, belongs squarely in the former camp, Mr Huhne has slanted his pitch towards the latter. Their favourite historical figures are revealing: Mr Huhne admires Lloyd George, the chancellor he calls “the father of the British welfare state”, while Mr Clegg prefers those who have stood against state power, such as Vaclav Havel, the Czech dissident, and Harry Willcock, a Liberal activist who campaigned against identity cards in the 1950s.

Mr Huhne is a credible candidate. He forged successful careers outside politics, first as a journalist (including a spell at *The Economist*) and then in finance. His grasp of economics (he made his millions selling economic research in the City) is valuable to a party that has tripped up on the detail of spending pledges before. And he is a strong and knowledgeable champion of green taxes, a subject in which voters are taking an increasing interest.

Yet he has failed to leave Mr Clegg in his dust: the two are level-pegging, with almost half of Lib Dem members undecided. Though Mr Huhne has the more technical mind, Mr Clegg's experience in home affairs gives him an advantage on the sorts of non-economic issues that are becoming increasingly prominent. His proposal of a managed amnesty for illegal immigrants is both radical and reasonable. He is a constructive critic of the government's record on civil liberties without losing sight of the threat that terrorists pose to national security. He has called for liberals to address the issue of cultural identity, arguing that multiculturalism cannot extend to tolerating intolerance or turning a blind eye to segregated communities.

There are reasons to be cautious about both candidates. Mr Clegg has run a flat campaign, and was rattled when his rival attacked him. He is the more natural communicator, but comparisons with David Cameron, the Conservative leader, are not yet justified. His promise of a “new kind of politics” echoes similar pledges by politicians who went on to revert to partisan point-scoring, including Mr Cameron. Nor does Mr Huhne inspire total confidence. His support for massively shrinking Britain's nuclear deterrent seems rash, and he is also unduly alarmist about public-service reform.

All in all, however, the Lib Dems are lucky in their candidates; and partly as a result, the party is picking up in the polls. They are luckier still in their acting leader. Mr Cable—who coined the single best line of Gordon Brown's premiership this week when he pointed out that the prime minister had metamorphosed from being Stalin to Mr Bean—is having a very good war.

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Bagehot

# Off with their heads

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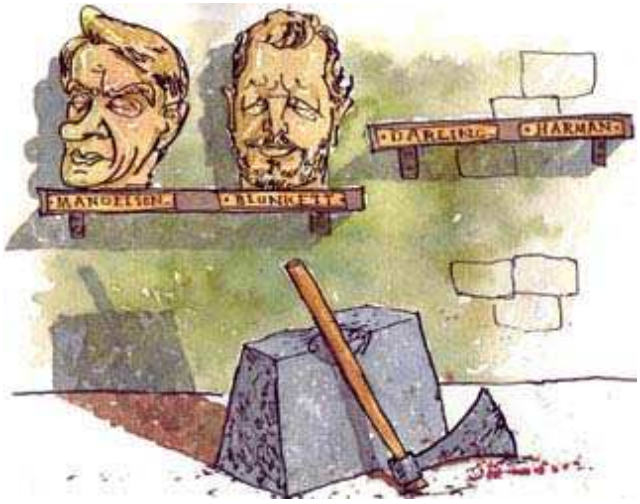
Illustration by Steve O'Brien




**When and why ministers resign—and what it will mean if they start to now**

> We demand a committee, a representative committee, a committee
>
> of investigation/ RESIGN RESIGN RESIGN
>
> "Coriolan" by T.S. Eliot

BILL CLINTON is a hero for many in the Labour Party. When the Senate acquitted him, left-leaning Britain cheered. But if he had been British, and Monicagate had unfolded in Number 10, Mr Clinton would have been obliged to fetch his coat long before the dress was out of the closet. Compared with some countries, and indeed with its own past habits, Britain's modern political culture craves resignations. This week "Resign, resign, resign" again rings across the editorial pages, between the benches of the House of Commons and in Gordon Brown's ears.

When should ministers or other senior officials "resign"—usually if not always a euphemism for "be sacked"? As well as a wordy code of ministerial behaviour—revamped, it should be said, by the Labour government, like the rules on party funding that Labour proceeded to violate—there are a few generally accepted conventions. Gross professional misconduct is a capital offence: Peter Watt, Labour's general secretary, who admitted knowing that huge donations were being channelled from a businessman to Labour via third parties, plainly had to go. Mr Brown was asked this week whether others might follow him—such as Harriet Harman, who took money from the discreet donor to help pay for her successful bid to become Labour's deputy leader. With (for once) an authentic smile, Mr Brown offered the Rumsfeldian conclusion that "if the inquiry [into the donations] names names, then these names will be named."

Proven lying, especially to Parliament, also means curtains. So does a minister making himself look ridiculous. Conservatives generally achieved that in the bedroom, though the country now seems to have become less prudish; in opposition, one of the main peccadilloes for which Tories get the boot is holding retrograde views on race. Resignations on matters of principle are commendable but rare, though they can be extremely damaging when they happen, as Margaret Thatcher discovered.

The toughest and most pertinent area to adjudicate involves mistakes, failure and incompetence. Mr Brown distinguishes errors of policy from errors made by individual civil servants; in the latter case, he says, ministers cannot be considered responsible. That, in his view, exonerates Alistair Darling, the chancellor of the exchequer and ultimate overseer of HMRC, the revenue service. (To remind—a week seems an unusually long time in Brownian politics—HMRC recently lost the personal details of 25m people

in the post.)

But other considerations also properly apply. Lord Carrington, for example, was right when he decided the cock-ups that led to the Falklands war required a ministerial sacrifice. Sometimes—as, some argue, in the case of Sir Ian Blair, boss of the Metropolitan Police, whose officers killed an innocent man wrongly suspected of terrorism in 2005—the opposite case can be made: that a resignation would be dangerously bad for morale. Sometimes the top dog is best placed to sort out his own mess.

So it is tricky to decide who should, in principle, resign and for what. In reality, the rules are rather simpler.

## By their fingernails

When suicides are dredged from the Seine, it is said, the lovers and the debtors are easy to tell apart: the lovers have paint under their nails, from trying to claw their way back on to the bridge at the last moment, whereas the debtors sink like stones. In British public life, those who let go easily tend to be either young enough to come back later (such as Anthony Eden, who resigned in 1938 and became prime minister in 1955), or close enough to their pensions to be blasé (like, say the uncharitable, the head of HMRC, Paul Gray, who fell on his sword on November 20th). Still more important than the official's own inclinations is how beloved he is of the prime minister.

A potential resigner may be retained because of the controversy he arouses as much as in spite of it. Most calls for ministerial resignations—and recent ones especially—are really proxy attacks on the prime minister. Even more than most, Mr Brown needs to keep his chancellor as a lightning rod for bolts of criticism that might otherwise strike him. But the ultimate determining factor in all this is the stability of the government.

A decent resignation can provide a fillip to the popularity of an embattled premier. But resignations also reflect and worsen weakness, because a government that acquiesces to calls for ministerial heads is perceived as too flimsy to resist them. That seems to have been the lesson that Tony Blair drew from the incessant culling in John Major's sleaze-prone government. Mr Blair was almost recklessly loyal in some cases, reinstating both David Blunkett and Peter Mandelson (his own lightning rod) to cabinet roles after their falls from grace. The intransigence was both a function of his strength and a contributor to it.

On this score, Mr Brown appears keen to emulate his predecessor. For the moment he is calculating that, despite the past catastrophic fortnight, he is not yet in such a hole that the short-term benefits of “resigning” Mr Darling or Ms Harman (conspicuously sitting next to him at prime minister's questions on November 28th), or any of the other candidates for the chop, would outweigh the long-term emasculation that the loss would inflict. Instead he has set up his assorted, Eliot-esque committees of investigation, and introduced a new vogue for humble but self-exculpating apologies.

He may be right. Labour is only halfway through its electoral mandate and could yet recover its momentum. But if the funding or data scandals deepen, Mr Brown may yet be forced to offer up a pound of ministerial flesh. If that happens, it will be a leading indicator of his own political demise.

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Climate change

# Struggling to decode Bali's message

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AP

**A green jamboree in Indonesia will not achieve anything tangible, but it matters**

IF SIZE is a measure of importance, the meeting of the United Nations Framework Convention on Climate Change (UNFCCC) that starts in Bali on December 3rd is a big deal. Somewhere between 15,000 and 20,000 politicians, officials, activists and journalists are expected to attend, stretching the Indonesian island's resources to breaking-point. “It's a nightmare for those of us who are actually working on the agenda,” says an official who is attending. “We won't be able to get internet access or food.” The recent floods in parts of Indonesia (shown above) may help concentrate minds.

The numbers of people pouring into Bali next week do at least demonstrate that the political profile of climate change has risen over the past year. Nobody whose job touches on global warming can afford to be absent. And the issue that the meeting is primarily about—how the world should try to mitigate climate change when the Kyoto protocol runs out in 2012—is crucial.

The omens, too, are good. Those who support a global agreement along the lines of Kyoto, based on targets for cutting greenhouse-gas emissions, got a boost from the results of the Australian elections. Kevin Rudd, the country's new prime minister, has promised to reverse his predecessor's policy and ratify Kyoto.

But expectations for Bali are low, and are being managed downwards before the meeting. “Disappointment may come in a variety of different guises,” says an official. Those, like the EU and the NGOs, who want a global deal are not even looking for a road map for the post-2012 era. They will be happy if they manage to stop America, OPEC or the developing countries creating serious roadblocks.

It is not surprising that Bali is unlikely to achieve anything tangible, for it is aimed at the hardest part of climate-change mitigation—getting an international agreement which all the big emitters ratify. That won't happen until America adopts serious domestic emissions-control measures.

But encouragement from the international front would ease the passage of such measures considerably. So what happens at Bali matters, though the declaration that comes out of it will be encrypted in diplomatic language, and the difference between success and failure will be imperceptible to the untrained eye.

Experienced code-breakers will be looking, essentially, for three things by which to judge whether Bali has been a success or a failure. The first is some sort of long-term commitment by all 192 signatories of the UNFCCC to deal with the problem, involving some sort of goal, such as temperature, emissions cuts or atmospheric carbon concentrations. The second is further commitments by developing countries to cut

their emissions. The EU already committed itself to cuts of 20% below 1990 levels by 2020 at its spring conference earlier this year; and since the current American administration continues to oppose binding targets, such promises will have to come from other rich countries, such as Australia or Japan.

The third area concerns developing countries. They are not going to commit themselves to cuts. But activists hope that China and India—the nations everybody is watching—may throw America a bone. If the big developing countries agree to look into cutting emissions from particular sectors—an idea that the Bush administration has pushed—rather than from their economies as a whole, America will be likelier to commit itself to emissions controls. After all, it was the developing world's refusal to countenance cuts that led America to turn its back on Kyoto in the first place.

This is all familiar territory to climate-change aficionados. But there is one area in which the Bali meeting may break new ground: deforestation.

The Kyoto protocol established a mechanism (see article) under which developing countries that cut their industrial emissions can sell those reductions to rich countries. But developing countries have no incentive to stop cutting down their forests, and tropical deforestation accounts for around 20% of total annual greenhouse-gas emissions. So a group of heavily-forested countries have been lobbying to get paid for not cutting down their green canopies.

This initiative has met plenty of opposition, and not just from the many who point out that designing a scheme to pay people not to do something is tricky. Brazil, home of the world's largest expanse of tropical forest, has also been wary of the idea. It was instrumental in designing the Clean Development Mechanism, which it is doing very nicely out of, and it fears that flooding the market for carbon credits with new supply from tropical forests would depress the price and destroy the mechanism. It is also uncomfortable about the implication in an “avoided deforestation” programme that its forests are the whole world's property.

But as Brazil has come to take the issues of both climate change and deforestation more seriously, so its opposition to such a programme has moderated. That, and the world's realisation that without addressing deforestation, mitigating climate change will be exceedingly difficult, has brought forests to the fore.

Even on deforestation, though, there will not be a concrete agreement. The best that can be expected is—to use UN parlance—a commitment to look into creating incentives to discourage countries from chopping down their tropical forests. International diplomacy is a horribly slow business; and some such statement is probably a necessary first step towards, eventually, packing away the chainsaws.

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The Clean Development Mechanism

# How to make a clever deal cleverer

Nov 29th 2007 | SHANGHAI
From The Economist print edition

**Needed: a new way to get the Kyoto bargain to work**

SOME sceptics say the Clean Development Mechanism (CDM), part of the Kyoto protocol, is like paying someone else to stop smoking for you. The basic idea: projects that cut or prevent emissions of greenhouse gases in poor countries earn credits, which can be bought by rich countries in lieu of curbing their own emissions. After a slow start China now leads the pack in using the CDM, accounting for 61% of the market in 2006, which was worth nearly $5 billion.

The logical next stage for the CDM is a switch to a “programmatic” approach. Instead of approving abatement projects one at a time, this would allow similar projects to be grouped together for approval. Typical examples might include rural biogas, solar water-heating and small hydropower projects, all of which deliver “sustainable-development” gains too, says Anne Arquit Niederberger of Policy Solution, a consultancy.

One specific idea comes from the Joint US-China Co-operation on Clean Energy, a non-profit group. It plans to distribute 10m free compact fluorescent lamps to homes in China. This could save around 3.5m tonnes of carbon-dioxide emissions over four years. This is one of three projects being studied as a model for a future approach to the CDM. Sceptics are posing some hard questions: who will monitor individual projects within a programme? What if the market is flooded with credits, and prices crash? Findings from a forthcoming World Bank report on the CDM in China will be discussed in Bali; but this may produce more questions than answers.

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Mobile phones and protest

# Cats, mice and handsets

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From The Economist print edition

**Protesters and governments are mastering the tricks of the mobile trade**

BACK in September, protesters from many parts of the United States poured into the small town of Jena, Louisiana, to express their anger over the over-zealous prosecution (as they saw it) of six young African-Americans on charges of assault. Mobile-phone text messages played an important role in pulling in the crowd.

AFP

**Summoned by cells: the Louisiana march**

But for pioneers of mobile telephony and texts as tools of protest and dissent, simply summoning people to demonstrations—a technique first deployed in the Philippines as long ago as 2001—is old hat. The search is on for ever more creative ways to use this ubiquitous device.

At a recent conference in São Paulo on “mobile activism”—a term that embraces humanitarian work as well as protest—there was much talk about how to “go beyond text” when using mobile phones. And it became clear that exuberant practice was galloping ahead of theory. One recent craze has been the use of political ringtones. Once again, Filipinos are in the vanguard. Since 2005 that country's best-known tone, especially among youngsters exasperated by corruption, has been “Hello Garci”—a snatch of taped conversation in which President Gloria Macapagal-Arroyo seems to be chatting with Virgilio Garcillano, her election organiser, ahead of the 2004 poll that confirmed her in office. In Hispanic countries, meanwhile, the latest fashion is a royal voice saying “Why don't you shut up?”—the recent outburst of Spain's King Juan Carlos to President Hugo Chávez of Venezuela at a summit in Santiago, Chile.

Mobiles are also being used in more sophisticated ways, to capture and disseminate images that were never supposed to see the light of day. Witness, a non-governmental organisation that aims to record and denounce human-rights abuses, is one pioneer. Instead of merely posting verbal reports, it invites visitors to its website to the “Hub”—a collection of harrowing video clips, often uploaded from mobiles, which depict cruelty in action. On the “Egypt” country page, there are grainy images showing torture in a prison.

For now at least, expense and technological problems make it hard to organise any international mobile-based protest. The lack of full interoperability between mobile systems means that borders are still difficult to cross. But efforts are under way to get round that problem. For example, FrontlineSMS, a laptop-based (and thus portable) technology has been designed for use almost anywhere. Early this year it was deployed in the monitoring of elections in Nigeria. Voters texted complaints to a computer where they could be processed and cross-checked by monitors from international bodies such as the European Union.

More recently FrontlineSMS was used in Pakistan to get round curbs on information flowing in and out of the country. Both there and in Myanmar (Burma) recent disturbances have produced some interesting insights into the cat-and-mouse games of protesters and political masters.

In Pakistan the equipment used by local authorities was too cheap to block the flow of text messages. This helped Pakistani protesters to stay informed about sympathetic rallies taking place in America and Britain—and to give the outside world a glimpse of ordinary people's reactions to the state of emergency.

During the recent protests in Myanmar, the authorities temporarily suspended text messaging altogether. That did not stop activists from using expensive satellite phones, which are harder to shut down. The political, and above all, economic cost of blocking text messages was relatively low in Myanmar, because not many people use mobiles. But in many other developing countries, shutting mobile systems would be economically disastrous and politically costly, because so many small businesses depend on them.

In some places, like Belarus, the authorities have refined the art of blocking mobile coverage in specific places—such as protest venues. They have also turned text messages to their own uses: by using the state-owned network to spread warnings that a rally is likely to end in bloodshed.

For hard-pressed activists in search of new techniques, help may come from an unlikely quarter. Google, the internet giant, has offered $10m for the most innovative new application for mobile phones. The offer extends to ideas that bring humanitarian benefits or contribute to economic development. Mobile activists have never lacked imagination, and many of them are already hard at work, thinking of clever new uses for those little devices—mostly rather crude, five-year-old models—that have become part of daily life in the poorest parts of the world.

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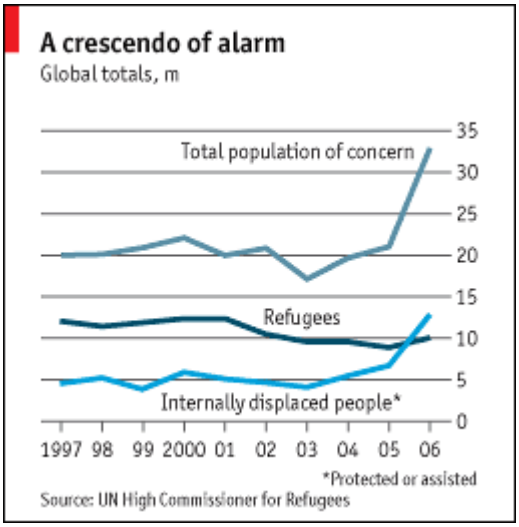
Statelessness

# It's tough to live in limbo

Nov 29th 2007 | NEW YORK
From The Economist print edition

**The growing danger of falling between the cracks of geopolitics and war**




THEY are people who struggle to make their voice heard, but the world is likely to hear more and more about them. If they all belonged to one nation, it would be a fair size, as big as Chile or Kazakhstan. Yet by definition, they belong to no country at all: they are the world's growing band of stateless people who have no citizenship rights, and are often unable to claim the things that states can provide, like travel documents and education. According to international officials whose job is to cope with human flotsam and jetsam, the problem of statelessness is growing fast, despite a modest decline in the number of refugees in the strict sense.

In a cautious estimate, the office of the United Nations High Commissioner for Refugees reported that in the course of 2006 the number of stateless persons had climbed from 2.4m to 5.8m. That was one reason for a recent spike (see chart) in the number of "people of concern" to the UNHCR. A better guess for the stateless, says Maureen Lynch of Refugees International, an aid agency, is at least 11m; some UNHCR officials say the total figure, using looser criteria, could be 15m.

Some people become stateless because they are forced out of one country, and no other nation will accept them, or even grant them the rights which "refugees"—people who seek shelter because of a proven risk of persecution—can claim. Some people never leave home but find they are stranded by a shift in borders. Also ranked among the stateless are marginal groups who cannot claim civic rights because their births went unrecorded.

As a classic case of statelessness, take the Biharis of Bangladesh. They mostly took the West Pakistani side in the 1971 war that led to the creation of Bangladesh, ensuring that they were unwelcome in the new state. Some were moved in organised exchanges—until Pakistan stopped taking them. Perhaps 300,000 remain stateless.

In fact, legal limbo is not an either-or condition; there are degrees of statelessness. Among the Palestinians (and their descendants) who fled during the war that followed Israel's creation, some—those in Jordan—were given passports, but in other Arab states, they simply got "refugee travel documents". No Arab state wanted to naturalise the newcomers, but their level of rights has varied from place to place.

In 1991, in newly free Estonia, those inhabitants (mainly Russians) who were there as a result of the Soviet occupation could claim citizenship only if they passed a language test. Many have. The remainder are not wholly without rights; they may vote in municipal elections, for example. A "non-citizen" of law-abiding Estonia may enjoy more state protection than a subject of some ramshackle place where state power is either absent or murderous.

Still, there are some strange, avoidable forms of statelessness that reflect quirks of history. When the Arab Gulf states were formed, some used tribal affiliation rather than borders to determine citizenship. This left many stateless, including the *bidoun* ("without" in Arabic) of Kuwait; perhaps 100,000 people who cannot prove their family's residence in Kuwait since 1920, and thus cannot become citizens under a harsh 1959 citizenship law. The situation is exacerbated by a feature common to all but three Arab states: mothers married to non-citizens cannot claim citizenship for their children. The *bidoun* forfeit the amenities that the oil-rich emirate showers on its citizens, including education.

António Guterres, the current high commissioner for refugees, says more and more countries agree, at least, that statelessness is a problem; and several have taken steps to alleviate it. One happy story is that of Nepal, where poverty and isolation had left some 3.4m people, some ethnically non-Nepali, outside the purview of the state. This year, the government managed to register 2.6m of them.

Elsewhere, legal changes are easing the problem. Egypt, Morocco and Algeria have altered their family law to allow mothers to pass on their citizenship. Bangladesh's government has recommended giving citizenship to the Biharis. Even Kuwait is tackling the *bidoun;* there was a parliamentary enquiry into the issue in 2006 and a promise, this year, to begin widening citizenship, initially to a mere 2,000 people.

But a 1961 convention on reducing statelessness has been signed by just 34 countries, most recently by New Zealand, Rwanda and Brazil. Many states are wary of losing sovereignty or undertaking expensive obligations. Welcome as they are, the recent efforts to tackle the problem fall far short of what is needed to put into practice the 1948 Universal Declaration of Human Rights, which lays down that every human being is entitled to a nationality.

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# Going hybrid

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From The Economist print edition

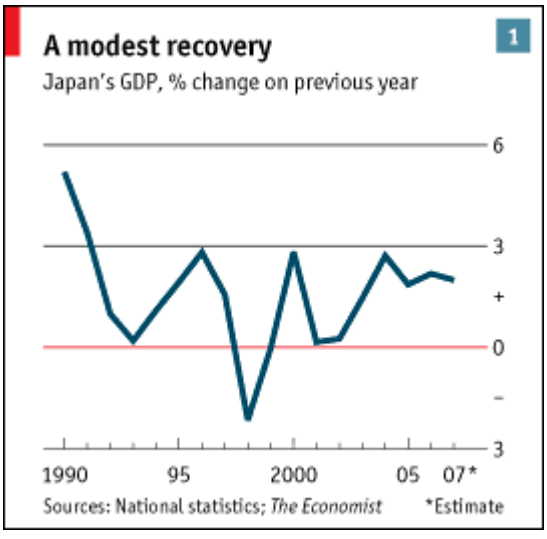
Illustration by Jac

**After 15 years of gloom, Japan's companies have emerged with a new, hybrid model a bit closer to America's, says Tom Standage**

Get article background

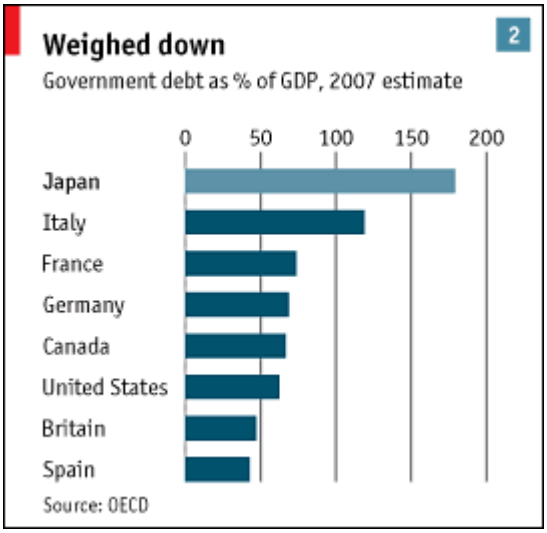
ONCE it was the Walkman. Then it was the PlayStation. Today it is the Toyota Prius that epitomises Japan's technological and industrial prowess. Built by Japan's largest company, which is now on the verge of becoming the world's largest carmaker, the Prius is a hybrid car propelled by the combination of a petrol engine (for range) and an electric motor (for energy-efficiency). The Prius was the first commercial hybrid car and has become by far the most successful, with sales of over 1m since its launch in 1997. Although that is a modest figure compared with Toyota's annual output of around 8m vehicles, it has transformed the company's image. Toyota is now known for greenery and innovation as well as manufacturing efficiency.

But the Prius also symbolises another transformation: that of Japan itself. Just as a hybrid car combines the distinct advantages of petrol and electric propulsion systems, Japan has been developing a new hybrid model of capitalism that brings together aspects of the old Japanese model, which ran into trouble in the early 1990s, with carefully chosen elements of the more dynamic American or Anglo-Saxon variety of capitalism. The resulting hybrid model has been adopted by many firms and has already helped to transform Japan's fortunes. After wrenching political and corporate reforms, the country in 2002 emerged from over a decade of economic stagnation. Since then the recovery, originally export-led, has spread to the economy as a whole (see chart 1). Japanese firms have restructured, paid down their debts and are now posting record profits. The banking system has been cleaned up. Yet despite this progress, Japan still faces huge problems.




Government debt, at around 180% of GDP in the current fiscal year, is the highest for

any developed economy (see chart 2). The government will soon have to raise consumption taxes just to stop the debt from growing. Japan also faces a painful demographic squeeze as its population ages and the workforce starts to shrink. This will put a premium on increasing labour-productivity growth, which at 1.2% is only half the OECD average, largely thanks to the hugely inefficient service sector, which accounts for 70% of GDP and two-thirds of employment. Japan's average labour productivity in services fell from 88% of the American level in 1993 to 84% in 2003. This highlights another of Japan's problems: its two-tier economy, made up of an efficient, globalised manufacturing sector and an inefficient, inward-looking services sector.




Japan also risks losing its edge in innovation. Although it spends far above the OECD average on research and development (R&D) as a share of GDP, this money is not always put to good use. The Science Council of Japan estimates that Japan's R&D is only about half as efficient as Europe's and America's. Entrepreneurial start-ups account for only around 4% of firms in Japan, compared with 10% in Europe and over 14% in America, and Japan comes bottom in several rankings of entrepreneurship. Despite the might of its big exporters, Japan is also a laggard in globalisation, with the lowest levels of foreign direct investment, imports and foreign workers in the OECD. With a domestic market that offers little scope for growth, Japan is missing out on opportunities overseas.

## Time for a new model

Its old industrial model, which formed the basis of the “Japanese miracle” in the second half of the 20th century, was devised under very different circumstances: high growth and a pyramidal population structure, with far more young people than old, notes Atsushi Seike, a labour economist at Keio University in Tokyo. This old model was founded on three main elements: first, lifetime employment, in which workers spend their entire career at the same firm, slowly working their way up the ranks; second, seniority-based pay, which links wages to length of tenure rather than ability; and third, company-specific unions, which promoted close co-operation between unions and management.

Another typically Japanese practice was a close relationship with a “main bank” and other companies organised into corporate groups known as *keiretsu*, bound together by a web of reciprocal cross-shareholdings. The old model was well suited to the times: it delivered social stability and cohesion as Japanese workers pulled together to catch up with Western nations, and helped Japan to become the world's second-biggest economy.

But the population structure has changed beyond recognition and Japan is no longer a developing country, so the old model no longer fits and many of its strengths have become weaknesses. It hinders consolidation among Japanese firms, which is necessary if they are to become more globally competitive. It prevents the efficient redeployment of labour and a proper use of women and elderly workers, which will be vital if Japan is to cope with its ageing population and shrinking workforce. The old model hampers entrepreneurship and innovation in small companies, an important component of a dynamic and responsive economy. All of this acts as a brake on growth. At the same time, Japan needs to become more closely integrated into the global economy, both to gain access to fast-growing foreign markets and to enable competition from foreign firms to spur improvements in the stodgy services sector. That is why a new, more flexible model is needed.

In the late 1990s, when Japan had endured almost a decade of stagnation, the American model seemed to have all the answers—a reversal from the 1980s, when American firms were trying to emulate the seemingly unstoppable Japanese model. America's economy was booming, fuelled by a flourishing technology industry. Its approach seemed more successful at promoting innovation and growth in the

internet era, and its vibrant start-up scene was a far cry from Japan's staid big-company capitalism.

So policymakers rewrote corporate law to allow Japanese companies to adopt an American-style model of corporate governance, and some companies began to adopt Anglo-Saxon practices such as performance-based pay, share options, outside directors, promotion based on ability, pursuit of shareholder value and hiring new employees in mid-career. The banking system was recapitalised, cross-shareholdings were unwound and companies embarked on a programme of restructuring. “But a funny thing happened on Japan's way to the American model—it never got there,” observes Steven Vogel, a political scientist at the University of California, Berkeley. Many of the reforms met with opposition and were scaled back. Then the dotcom crash and the Enron scandal caused the American model to lose its lustre, to the delight of Japan's old guard.

Instead, forward-looking Japanese firms have devised a hybrid model that combines elements of both the old Japanese and the Anglo-Saxon model. “We have been going through a process of trial and error, of what to change and what not to change,” says Fujio Cho, the chairman of Toyota. The effect has been to move Japan somewhat closer to the American way of doing things, at least in some areas and in some companies. “You pick and choose which bits you adopt,” says Hirotaka Takeuchi, dean of the school of corporate strategy at Hitotsubashi University. “Japan has tilted more towards the Anglo-Saxon model, but wants to go its own way. The debate is about how far to tilt.”

Sir Howard Stringer, the first non-Japanese boss of Sony, the Japanese electronics giant, embodies the attempt to combine Japanese and Anglo-Saxon approaches. “In our company, as in others, there was a lurch towards the Western model,” he says. “My job is to manage that without alienating Japanese sensibilities. Some of the virtues of the Japanese model have to be retained. It is a balancing act, sometimes stimulating, sometimes frustrating, but there is merit on both sides.” It helps that he is a foreigner but not an American, admits Welsh-born Sir Howard.

## Finding the right balance

But now that the economy is growing again, there is much debate about whether Japan has found the right balance or whether more reform is needed—or even whether it is time to reinstate some of the old ways. After the departure of Junichiro Koizumi, the charismatic and reformist prime minister who held office between 2001 and 2006, there is a sense that the political momentum for change has been lost. Instead, there is growing concern that the spoils of the recovery have not been equitably distributed, and that inequality is rising—a worrying phenomenon for a society in which 75% of people once identified themselves as middle-class.

“There has been a backlash recently, particularly since we recovered from the recession,” says Mr Seike. This contributed to the fall of Mr Koizumi's successor, Shinzo Abe, who resigned in September. Japan's new prime minister, Yasuo Fukuda, said in his first policy speech in October that “in promoting structural reform, we have seen disparity and other problems surface.” He was committed to further changes, he said, but would also address the inequalities arising from previous reforms.

Japan is now at a crucial stage. “Owing to the recent resurgence of the Japanese economy, support for reform is beginning to fade and the future of Japan can be said to be hanging in balance,” notes a report from Keizai Doyukai, a business lobby. Much of the political wrangling in Japan, and the various takeover battles and showdowns between activist investors and corporate executives, can be seen as part of the debate about how much more Japan needs to change, and how large a component of American or Anglo-Saxon capitalism ought to be incorporated into the new hybrid industrial model. “Japan has to Anglo-Saxonise, but in a Japanese way,” says Yasuchika Hasegawa, the vice-chairman of Keizai Doyukai. “Japan has to find its own capitalism style.”

Not everyone shares his enthusiasm for the hybrid model, which pays more attention to shareholders at the expense of other stakeholders in a company—in particular, its employees. There is obvious ambivalence about the adoption of American practices at Nippon Keidanren, Japan's conservative big-business association, which has campaigned to slow the pace of reform. When there are two models, says Masakazu Kubota, Keidanren's managing director, globalisation means the more competitive model will prevail. “Unfortunately, the most competitive system is in the United States,” he says.

In part, Keidanren is trying to shield its more dinosaur-like members from reform. But its scepticism reflects a wider concern. Japanese companies are social institutions, providing social cohesion and taking on many roles that in other countries are performed by the state. By contrast, the Anglo-Saxons view

companies as money-making machines that can be freely bought, sold, merged and dissolved in order to maximise returns to shareholders. “What makes Japan interesting is that it's a society having a debate about shareholder versus stakeholder capitalism,” says David Marra, a Japan specialist at A.T. Kearney, a consultancy. “Japan is at a potential tipping point for the next few years.”

Yet despite the current political paralysis, reform has taken on its own momentum. The slow drip of legal and regulatory changes, many of them passed by previous administrations or introduced by Japan's powerful bureaucracy, continues. Individually, some of them do not amount to very much, but collectively they add up to a change in the Japanese business environment. “Retrospectively, the changes during the past decade were significant, and we are a different country now in many respects,” says Mr Hasegawa.

This special report will look at four of the most important areas of change: corporate governance, the labour market, the climate for entrepreneurs and innovation, and Japan's response to globalisation. It will examine what has changed and what has not; how and where Japan has struck compromises between the Japanese and Anglo-Saxon models; how widely the new hybrid model has been adopted; and whether it will be able to solve Japan's many problems.

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# Message in a bottle of sauce

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Illustration by Jac

**Japan's corporate governance is changing, but it's risky to rush things**

IT WAS not a storm in a teacup but a battle over a bottle of sauce. The fight during 2007 for Bull-Dog Sauce, a Japanese condiment-maker with 27% of the sauce market, cast into sharp relief the conflict between no-holds-barred Anglo-Saxon capitalism and the traditional Japanese approach to corporate governance.

The supposed villain of the piece was Steel Partners, an American investment fund that since 2000 has invested more than $3 billion in some 30 Japanese companies. Having built up a 10% stake in Bull-Dog, Steel launched a takeover bid in May, offering to buy all outstanding shares in the company for around $260m, a 20% premium over the share price at the time. Bull-Dog's management opposed the bid. “Why us?” lamented the firm's managing director, Masaomi Tamiya. Steel was accused of being a “greenmailer”—a predator that buys a large share in a company, threatens to take it over and then agrees to drop its bid and sell its stake back to the company at a hefty premium. Warren Lichtenstein, Steel's boss, insisted that Steel had a long-term commitment to Bull-Dog. But on a visit to Tokyo to meet Bull-Dog's management, he made matters worse by saying he planned to “educate” and “enlighten” Japanese managers about American-style capitalism.

At its shareholder meeting in June, Bull-Dog proposed to enact a “poison pill” defence that involved issuing three new shares for every existing share to all shareholders—except Steel, which would instead receive cash, diluting its original stake. Mr Lichtenstein gave warning that the poison pill could set a dangerous precedent and deter investment in other Japanese companies. But that, of course, was the whole idea. The poison-pill motion was passed, and although Steel mounted a legal challenge, Bull-Dog's right to use the device was upheld by the courts. So the foreign investors were thwarted, but at great cost to Bull-Dog, which said it expected to make a loss of ¥980m ($8.3m) for the year to March 2008, rather than the previously forecast profit of ¥500m.

The Bull-Dog saga was a litmus test for attitudes to shareholder capitalism. Those who believe that companies should be run to maximise the returns to shareholders thought that shareholders should have accepted Steel's generous offer; but those who hold the traditional Japanese view that companies are social communities, not baubles to be bought and sold, disapproved of Steel's treatment of a venerated 105-year-old company.

Both sides have a point. Japanese companies have neglected their shareholders for too long. But, says Gerald Curtis, a Japan-watcher at New York's Columbia University, Steel's “heavy-handed, flat-footed approach” has made it more difficult for others to argue that companies should pay more attention to their shareholders. “A lot of Japanese in the business and financial community are mainly mad at Steel because they make it more difficult for Japan to do what it has to do,” says Mr Curtis.

For one thing, Japanese firms tend to sit on piles of money: the cash and securities they hold amount to 16% of gross domestic product, compared with a long-term average in America of around 5%. And Japanese companies' average return on equity is only around 9%, compared with 14-17% in America and Europe. Under a previous set of rules, dividend payments were taxed whereas capital gains were

not, so Japanese investors were more interested in share-price gains than in dividends; but those rules no longer apply. And the proportion of Japanese shares held by foreign investors has increased hugely, from 5% in 1990 to 28% now. Both these changes have increased the pressure on companies to use any excess cash to increase dividends, or to buy back shares to boost prices.

Foreign investors have been demanding this for years, but domestic investors are now following suit. A pioneer in this field was Japan's most famous activist investor, Yoshiaki Murakami, a colourful and controversial figure who in July was found guilty of insider trading and sentenced to two years in prison. Although Mr Murakami plainly went too far, he helped make the case for a greater emphasis on shareholder returns. Japan's Pension Fund Association, a quasi-governmental body that oversees investments worth more than $100 billion, said this year that it would press firms to pay higher dividends and would vote against directors of companies making inadequate returns.

Another example of an investor exerting pressure involves Sparx Group, a Japanese investment fund that was the largest shareholder in Pentax, a camera-maker. In April Pentax changed its mind over an agreed takeover offer from another Japanese firm, Hoya, the world's biggest producer of optical glass, and ousted the company's president who had devised the deal. But Sparx, along with other investors, felt that being bought by Hoya would be the best option for Pentax as well as for its shareholders, so it got the ousted president reinstated, prompting the Pentax board to resign. The deal went ahead on improved terms. Sparx prevailed by handling the situation delicately. “That's their style—not to put up a loudspeaker,” says David Marra of A.T. Kearney.

Similarly, in February another Japanese investment fund, Ichigo Asset Management, successfully persuaded shareholders in Tokyo Kohtetsu, a steel company, to reject a merger with Osaka Steel. This was the first time that shareholders in a Japanese company had ever rejected a merger plan already approved by the two companies' boards. Ichigo, which held a 13% stake in Tokyo Kohtetsu, approved of the logic of the deal but felt that the proposed share-swap short-changed Tokyo Kohtetsu's shareholders.

Some foreign activist investors are also taking a more subtle approach. The Children's Investment fund (TCI), for instance, which has a 10% stake in J-Power, an electrical utility, earlier this year pressed the company to triple its year-end dividend. TCI's boss, Christopher Hohn, began his letter to shareholders by apologising for writing to them out of the blue, then carefully explained why he thought that J-Power needed to do better. The company responded with a letter of its own, and in June TCI's resolution was defeated. “TCI trod carefully and decided to lose round one gracefully,” says Mr Marra approvingly. Investors who recognise that Japan is still getting used to a more activist approach (rather than treating Japanese firms in the same way they would treat American ones) will reap benefits in the long term, he says.

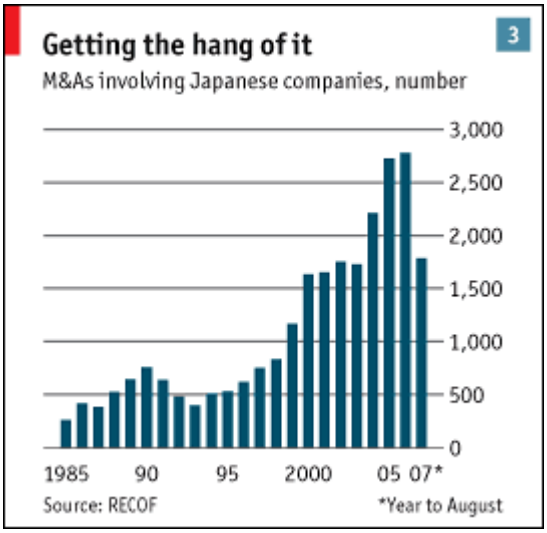
Japanese managers may not find it easy to switch their attention to shareholder value, but the trend towards greater shareholder activism is clear. This year around 30 companies have faced shareholder resolutions, double the 2006 figure. Many of them demanded higher dividend payouts. All such resolutions were defeated, notes Steven Thomas of UBS, an investment bank, but in many cases companies subsequently introduced their own resolutions to increase dividends by a smaller amount, in effect meeting the activists halfway. Japan is gradually coming to appreciate the benefits that activist investors can provide, says Shoichi Niwa of RECOF, a specialist mergers-and-acquisitions consultancy.

## Learning to love M&A

Japanese firms are also changing their attitudes towards M&A. The pace is picking up (see chart 3) and the nature of the deals is changing. For most of the past decade, says Mr Niwa, M&A deals involved mainly domestic firms as they restructured and spun off non-core subsidiaries. But then the merger activity spread to the core businesses themselves, with consolidation in a number of industries including oil, steel, banking, insurance, pharmaceuticals and retailing. In the past two years Japanese firms have also made more acquisitions abroad. These are not the trophy assets of the late 1980s, but strategic purchases by Japanese firms to make themselves more globally competitive: Nippon Sheet Glass bought Pilkington, Japan Tobacco bought Gallaher and Toshiba bought Westinghouse, for example.

Changes in Japan's corporate law acted as catalysts. In 1999 it became possible to buy other firms using shares; in 2000 it became easier for companies to spin off non-core divisions. Accounting rules were also changed, forcing companies to produce consolidated statements and disclose cashflow figures

and making it harder to hide poorly performing subsidiaries. Another rule change requires companies to list assets at market value, which makes it easier to work out whether a company's market capitalisation is lower than the value of its assets (not uncommon in Japan). “There have been very drastic changes in this area in the past ten years—more drastic than anything seen before,” says Mr Niwa.




With each change, the rate of deal-making picks up. The latest one, which took effect in May, covers “triangular mergers” in which a foreign firm uses its own shares, via a Japanese subsidiary, to buy a Japanese firm. The first triangular deal, the takeover of Nikko Cordial by Citigroup, was announced in October. “Things are getting bought and sold in a way we didn't see in the 1980s and 1990s,” says Mr Thomas. Managers used to regard M&A as a sign of weakness, unnecessary for “good” companies. “But now they understand that M&A can be a good thing, that this is a standard part of the corporate toolbox,” he explains. Admittedly, the average level of M&A as a proportion of GDP, at around 3%, is much lower than that in America or Britain, at about 10%, but it is a lot higher than Japan's figure in 1991, when it was just 0.4% of GDP.

A bigger concern is that M&A activity is not playing its proper part, which is to make companies more efficient. That is because acquired companies often continue to be run as distinct firms within a firm, and the usual cost savings from laying off staff do not materialise because Japanese firms rarely sack people. Similarly, the opportunity to save money by replacing two brands with a single one is not always taken. “Companies have a face problem,” explains Katsumi Ihara, the head of Sony's electronics division. Employees and customers have strong attachments to companies and brands and want them to live on, which hinders M&A, he says.

Mr Marra points out that the average takeover premium paid in America is 25%, which reflects the cost savings that the buyer hopes to achieve. In Japan, the average premium is zero. “You don't pay anything because you're not going to do anything,” says Mr Marra. Instead, staff numbers are reduced by natural attrition, and brands live on.

Mr Niwa is more optimistic. Japan is now at the beginning of a new era of “fully fledged M&A”, he says, which will go beyond mere asset-shuffling to more radical restructuring. Japanese managers have spent the past decade getting used to the idea of M&A. “Now, at last, M&A is not something odd but a normal part of business.” There have even been a few attempts at hostile takeovers, something that was previously unheard of in Japan's cosy corporate culture.

## Hostile intent

When in August 2006 Oji Paper, Japan's biggest paper firm, tried to take over Hokuetsu Paper, a smaller rival, it was the first hostile bid by one blue-chip firm for another. Oji's bid made commercial sense: in an industry lumbered with overcapacity, it seemed a better idea to buy Hokuetsu, which had just invested huge sums in new equipment, than to splash out on updated equipment itself. But Oji's move was widely criticised, and the bid was blocked when Nippon Paper, the industry's number two, bought a stake in Hokuetsu, the value of which has since declined. Had Oji's bid succeeded, “it would have set a fantastic precedent,” says Mr Thomas. But hostile bids still seem to be regarded as taboo—though a recent survey by Japan's Cabinet Office found that 66% of companies said they were interested in pursuing M&A, and a further 6% said they would consider making a hostile bid if necessary.

A precedent would be a good thing, since it would help to convince Japanese firms of the merits of a more dynamic approach to M&A, says Marc Goldstein of Institutional Shareholder Services (ISS), a research firm. He cites Renault's alliance with Nissan, which convinced Japanese bosses that selling a big stake to a foreign firm could be a good idea, and also illustrated, in the person of Carlos Ghosn, that foreign managers could use their expertise to turn a Japanese company around. “There always needs to be a success story to convince corporate Japan of the merits of foreign practices,” says Mr Goldstein.

Similarly, he says, a successful triangular merger might change attitudes towards foreign takeovers. At the moment, many Japanese firms are worried that the new triangular-merger law

will lead to an outbreak of hostile takeovers by foreign buyers. The law was delayed for a year after a campaign by Keidanren, Japan's conservative big-business association, which gave companies time to put in place defensive measures, such as poison pills and cross-shareholdings with other companies—a once common practice that had been in decline for many years (see chart 4). Yet the new rules make it almost impossible to pull off a triangular merger without the approval of the target firm's management. And the big foreign firms that are most likely to take advantage of the new law would prefer to do friendly deals anyway, says Mr Goldstein, otherwise the Japanese firms they acquire will be difficult to run.

But there is no question that attitudes on things like mergers and shareholder value are changing, even if they still stop far short of Anglo-Saxon enthusiasm. According to figures from the Cabinet Office, the proportion of Japanese companies that describe themselves as “shareholder-focused” increased to 40% this year from 33% in 2002, and the proportion describing themselves as “worker-focused” fell from 18% to 13%. In other areas of corporate governance, too, Japanese companies have shifted towards a more Anglo-Saxon approach, but in a way that respects traditional Japanese sensibilities.

In 2002 the commercial code was amended to give Japanese companies a choice of two models for corporate governance: the traditional Japanese system with statutory auditors and an alternative committee-based system, modelled on the American approach, which involves separate audit, remuneration and nomination committees with a majority of outside directors. This was the most explicit example of the government's efforts to encourage Japanese companies to adopt a more American style of corporate governance.

But although several large companies immediately adopted the new system—including Sony, Hitachi, Toshiba, Hoya, Nomura and Nikko Cordial—very few others followed suit. Of the 1,750 companies in the Tokyo Stock Exchange's first tier, only 100 or so have adopted it. Still, many have gone for something in-between, sticking with the Japanese system but appointing more outside directors to their boards. Around one-third of Japanese companies now have outside directors.

The Japanese definition of “outsider” is not necessarily one that foreigners would recognise. One survey found that 30% of outside directors came from partner companies, 18% from other companies in the same *keiretsu*, 16% from a parent company and 5% from the company's “main bank”. True, some Japanese companies—Sony is a notable example—have installed genuinely independent outside directors on their boards. But others, such as Toyota, still do not have any outside directors at all.

In this aspect of corporate governance, as in many others, Japan has shifted towards a more American approach, but has retained many elements of the traditional Japanese way of doing things. “Japan sees a new thing and says: ‘Hold on, we don't do that’,” says Mr Thomas. “Then it says: ‘Oh, it's not so bad—but let's do it in a Japanese way’.”

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# Still work to be done

Nov 29th 2007
From The Economist print edition

**Japan's labour market is becoming more flexible, but also more unequal**

Illustration by Jac

IN THE summer of 2007 Toshifumi Mori moved back to Japan, having spent 14 years in America, Canada, Britain and Germany working for Mitsubishi, one of Japan's big industrial groups. He was struck by some of the advertisements he saw on the Tokyo subway. Such hoardings, he feels, “tell you what's in”. Alongside the posters promoting mobile phones and beer he was surprised to see advertisements for headhunters and recruitment firms. “There was nothing like that 15 years ago,” he says. He joined Heidrick & Struggles, one of several companies both promoting and profiting from a more flexible Japanese labour market.

Where he worked before, the traditional Japanese “lifetime employment” model was deeply entrenched. It is often said that this model is now collapsing and that the era of “jobs for life” has come to an end. But the reality is more complicated. For one thing, the traditional lifetime-employment system existed for only a few decades, and only at large Japanese firms; it was never universal. The system is now slowly crumbling, but only at the edges, notes Akira Kawamoto, the director of research at RIETI, a government think-tank. Most of the “salarymen” inside the traditional system will stay there until they retire. But the labour market is becoming more flexible in several ways.

Mid-career job changes, once unheard of, are no longer quite such a rarity. The strict seniority system is giving way to a greater emphasis on performance-based pay and promotion on merit. And the number of “non-regular workers” (a term that encompasses temporary, part-time and contract workers) is increasing. But much of this reflects efforts by Japanese companies to shore up the lifetime employment system for its “regular workers”, involving necessary concessions to keep the old system going. Useful though the reforms have been, they have also raised concerns about the growing inequality between regular and non-regular workers.

Under the traditional system, companies hired graduates and then invested heavily in their training and development. To keep workers loyal and protect their investment, they offered lifetime employment on steadily increasing pay, with generous fringe benefits and a lump sum on retirement. Employees worked their way up through the ranks, so age and seniority were tightly intertwined. This made it hard for people to switch companies in mid-career. Women who left to have children found they could return only to more junior, part-time positions. People competed fiercely for jobs at the best companies—but once they were in, their performance made no difference to their pay. “At Mitsubishi your salary went up by the same amount, no matter how hard you worked. My friends at foreign firms found this unbelievable,” recalls Mr Mori.

But this is now changing. Young people who start work at a big company no longer expect to stay there for their entire career. Some of them want more of a challenge, says Mr Mori; others “have seen what happens to people who move to another company and do well”. Foreign firms in Japan helped things along by poaching staff from Japanese firms, offering attractive benefits and better prospects for promotion on merit. “That creates more mobility,” says Mr Mori. “People hear success stories by word of mouth. If some people jump and become top managers, others want to do the same.” This is particularly noticeable in financial services, he says, but is spreading to other industries too. A common strategy is to start at a Japanese firm, move on to a foreign firm and then return to a Japanese firm in a more senior position.

## Signs of movement

A greater willingness to switch jobs also reflects declining confidence in the guarantee of lifetime employment, says Sakie Fukushima of Korn/Ferry, an executive-search firm. When she moved to Korn/Ferry in 1991, she says, on average only one in ten of the candidates she called was prepared to meet her. “Others would say they were not interested in moving or were scared by the term ‘headhunting'—we were thought to be industrial spies.” But after the dramatic collapse in 1997 of Yamaichi Securities, a securities-trading firm, there was “a huge change in psychology” as people realised that companies could fail. Today, she says, seven or eight out of ten people she contacts are prepared to meet her. “Many do not move, but they are interested to see what their options are.”

For their part, Japanese firms have become more willing to hire outsiders. With the fall from grace of the Japanese model in the 1990s and the increasing competitiveness of foreign firms, Japanese companies started to realise that they might benefit from outside expertise. There was also a “Carlos Ghosn” effect. When he first arrived at Nissan, Mr Ghosn was held in contempt by the corporate establishment. But within two years he had turned the company around, prompting a rethink among Japanese bosses.

More portable pensions have further increased labour mobility. Under the traditional Japanese system, employees qualified for a lump sum at retirement (over and above the state pension scheme) after 30 years at the same firm, which strongly discouraged mid-career moves. But some firms, most famously Matsushita, a big electronics manufacturer, have introduced a new scheme in which employees waive the lump sum at retirement in return for a higher salary. They can then put some of their extra pay into a personal pension plan, akin to an American 401(k), which they can take with them if they switch employers. This is particularly popular with women, says Mr Kawamoto. Workers who opt for it do not seem to be seen as disloyal. The tax system could be changed to encourage more people to use the scheme, he suggests: as things stand, the tax on traditional retirement income is low, but the tax treatment of portable personal pensions is comparatively ungenerous.

Performance-related pay has been another example of Japanese firms' experimentation with American ways of doing things. In some cases it started off as a form of wage restraint in the dark days of the 1990s: companies cut basic wages and employees hoped that performance-related pay might make up the difference, which it did not always do.

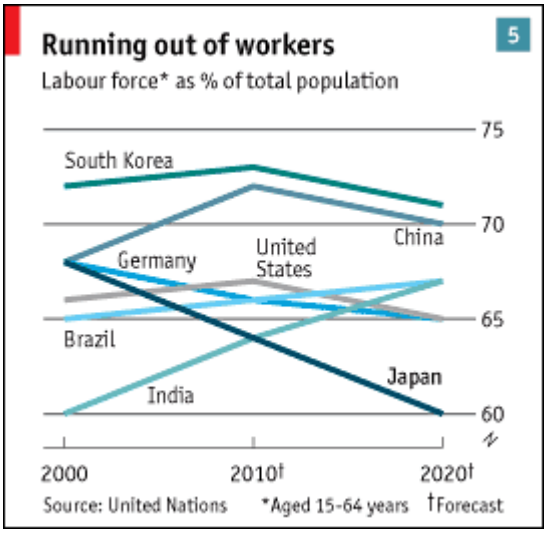
The idea met with stiff resistance. When Fujitsu, a Japanese computer giant, introduced a performance-based pay scheme during the 1990s, it proved so unpopular that the company had to scale it back. Managers found that workers became demoralised if they were not given above-average grades for performance—which, by definition, most could not be. NEC, another Japanese computer giant, introduced a similar programme and also had to modify it. Many firms now offer performance-based pay and other incentives, such as stock options, only to certain categories of worker, and keep the performance-related component small.

Along with performance-related pay has come a greater emphasis on meritocratic rather than seniority-based promotion. In recent years some firms have appointed younger chief executives, in their 50s, but many salarymen are unwilling to work under managers who are younger than themselves or who used to be their subordinates. Even within Sony, one of the most Americanised companies, old habits die hard. “I offered someone a senior job and he said: ‘But I'm only 48!',” says Sir Howard Stringer, the company's chief executive. “People thought seniority and skill were totally intertwined.”

As the labour market has become more dynamic for regular workers, however, the gulf between regular and non-regular workers has widened. When the recession took hold in the early 1990s, the idea that Japanese firms would make workers redundant was unthinkable. Instead, to maintain lifetime employment, companies held down pay and benefits for existing employees and stopped hiring new graduates. Spurred by changes to employment law, they also began to take on more non-regular workers on lower pay and short-term contracts. Whereas in 1994 non-regular workers accounted for only 19% of the labour force, the figure has since risen to 33%. This created a “lost generation” of graduates who were unable to get full-time jobs during the 1990s, got stuck in low-paid, non-regular positions in which no training was provided and found it difficult to move into regular employment.

There are different grades of people without regular employment. First come the “freeters” (a combination of “free” and *Arbeiter*, the German word for worker), those in temporary or part-time employment, whether by choice or necessity. Some freeters enjoy flitting between jobs, but many would prefer regular employment. According to a survey carried out in 2003, 40% of temporary workers and 22% of part-time workers said they would rather have a regular job but could not

find one. Next are the NEETs (those "not in education, employment or training") and the *hikikomori*, the twenty-somethings who withdraw from social life.




Most notorious are the so-called "net-café refugees", an underclass of non-regular workers who cannot afford accommodation in the cities where they work and instead sleep in rented cubicles in internet cafés. A recent government report put the number of such "refugees" at some 5,400 nationwide. That is not a lot, but it highlights an area of growing concern: inequality was one of the issues on which the Democratic Party of Japan fought its successful upper-house election campaign in July which led to the downfall of the prime minister, Shinzo Abe.

The protection of regular workers, in short, has come at the cost of a growing army of non-regular workers. The irony is that companies that claim to be committed to lifetime employment can meet this commitment only by cutting back on hiring regular workers and relying increasingly on non-regular workers. "Toyota and Canon say they are still keeping lifetime employment, but to do so they are introducing a large number of non-regular workers," says Keio University's Mr Seike. Canon, for example, now employs 70% of its factory workers on non-regular terms, up from 50% in 2000 and 10% in 1995. Non-regular workers typically earn half as much as regular workers for comparable work. About half of them are not covered by company pension or health-care schemes. But although the use of low-paid, non-regular workers reduces firms' costs, says Randall Jones of the OECD, it has the broader effect of constraining consumption, "so the expansion is still not firing on all cylinders."

That said, as the economic recovery causes the labour market to tighten—unemployment hit a nine-year low of 3.6% in July—companies are starting to move some non-regular workers into regular positions. UNIQLO, for example, a clothes retailer, said in March that it would turn 5,000 of its 6,000 non-regular workers into regular ones within two years, and Canon said it would do the same for 1,000 of its 13,000 factory workers. Companies are also readier to hire workers in their 30s, particularly those with specific skills, says Mr Mori. That is helping to mop up some of the lost-generation freeters.

The danger remains that Japan will find itself with a generation of middle-aged workers with inadequate levels of training, says Mr Seike. What is needed, he says, is a scheme to encourage companies to invest in training those in their 30s, with some of the training costs provided by the government. But the best way forward would be to close the gap between regular and non-regular workers by reducing the pay and benefits of the first group and creating better conditions for the second.

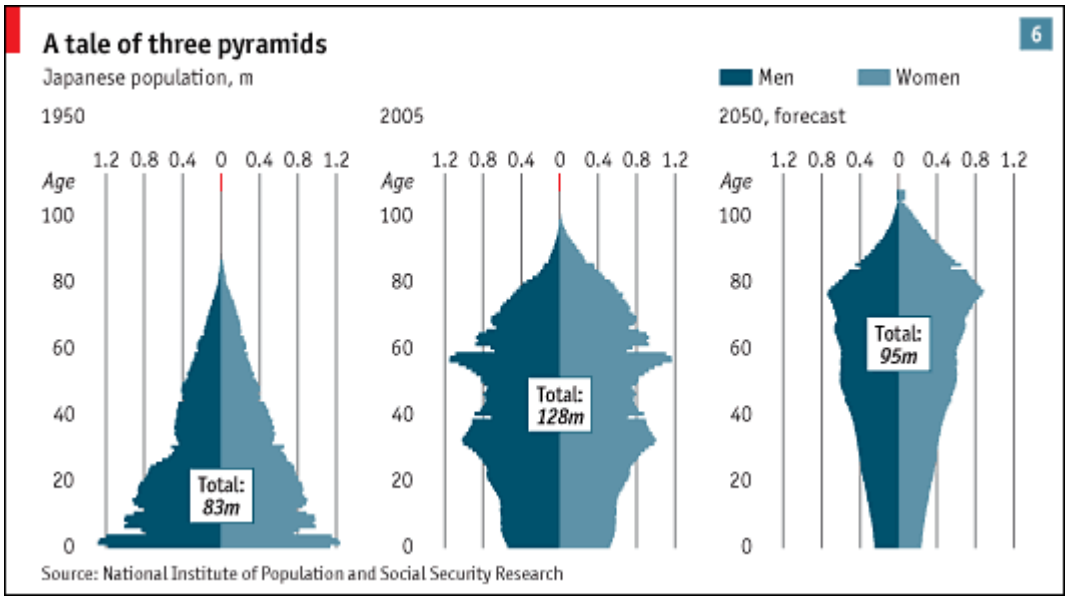
## Tick, tick

The reform of Japan's labour market is being driven by the need to become more competitive and flexible in the face of global competition. But Japan also needs to tackle a longer-term threat: the ageing of its population. The share of its population aged 65 or over, currently 21%, will rise to 25% by 2014 and 36% by 2050. Japan's fertility rate has also been declining, hitting a low of 1.26 in 2005, though it has since risen slightly, to 1.32. But that is still far below the replacement rate of 2.1 children per woman. So as well as ageing, Japan's population is now shrinking. By 2030 Japan will have two workers for every pensioner; by 2050 there will be only 1.5. Large-scale immigration, the solution favoured in other rich countries, is not culturally acceptable in Japan. So it will have to put more women and old people to work in order to maintain its workforce.

To this end, the government has already passed a law requiring companies to raise their mandatory retirement age or provide retraining and re-employment for older workers. Most companies favour the second option: the seniority-based pay system makes the oldest workers the most expensive, so it is cheaper to offer them lower-paid work in semi-retirement than to keep them on as full-time employees.

Japan's elderly are still willing to work, unlike their counterparts in Europe, notes Mr Seike. In theory, older workers could be put to good use training their younger colleagues. Raising the retirement age to 70 would roughly halve the rate of decline of the workforce. Increasing the participation rate of women from its current level of 61% (versus 69% in America) would help even more. Japan's working-age population is expected to decline by nearly one-fifth by 2030, and boosting female participation would be

the single most effective means of limiting the decline.




Many of the measures needed to do that, such as reducing the inequality between regular and non-regular workers and placing more emphasis on merit-based pay and promotion, would also improve flexibility more generally, notes Kuniko Inoguchi, who was minister for gender equality under the Koizumi government. But other measures that would specifically benefit women, such as better provision of child-care facilities, are also needed. Only 33% of children between the age of three and the mandatory school age (six in Japan) are in formal child care, compared with the OECD average of 73%. New rules for corporate child-care schemes and maternity leave for non-regular workers came into force in April. Big companies tend to offer child-care facilities already, but 90% of women in jobs work at small firms, which need to be persuaded to follow suit, says Ms Inoguchi.

Japan is doing its best to combine the stability and equality of its old labour-market system with the dynamism of the new. But as it becomes clearer that conditions for non-regular workers need to be improved and more women have to be encouraged to enter the workforce, the crumbling of the old system will accelerate.

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# Not invented here

Nov 29th 2007
From The Economist print edition

Illustration by Jac

**Entrepreneurs have had a hard time, but things are slowly improving**

TAKASHI MASUDA wiggles his finger next to an apparently random collage of tinsel, cuddly toys and cutlery, illuminated by a spotlight. A small black chip, glued to a plastic ruler, is propped up nearby, with wires running to a circuit board festooned with blinking red lights. From this another cable runs to a large high-definition TV where every ridge of the skin on Mr Masuda's finger, every twinkly highlight on the tinsel and every hair on the cuddly toys can be clearly seen.

Mr Masuda's company, Acutelogic, makes specialist image-processing chips and software for digital cameras. Its newest product, which picked up every nuance of Mr Masuda's wiggling finger, is a tiny high-definition video sensor that can fit into a mobile phone. The idea is to make camcorders obsolete, says Mr Masuda.

He founded Acutelogic after leaving Sony, where he worked on the team that created the Cyber-shot digital camera. He felt that the electronics giant's management had lost its way and wanted to start his own company. So he set up Acutelogic, with venture-capital funding, some investment from Fujitsu, a computer giant, and money raised from friends and family.

All this sounds very similar to the way things are done in America's Silicon Valley, where large firms such as IBM, Oracle, Sun and Hewlett-Packard often act as unofficial “incubators” for engineers who spend a few years learning the ropes and then leave to set up on their own. But Mr Masuda's story differs in one crucial respect: he was 50 when he left Sony, and was able to make the leap because he was offered an early-retirement package. “It would have been better to do it at 40,” he says. But had he done so, he would have lost his company pension. His story illustrates not how easy it is to start a company in Japan, but how difficult.

Japan scores poorly on almost every measure of entrepreneurship. It has the second-lowest level in the OECD of venture-capital investment as a share of GDP, and what little venture capital is available goes disproportionately into existing firms rather than start-ups. Venture-capital investment in Japan amounts to some $2 billion a year, around a tenth of the figure in America. Start-ups account for 4% of all firms, compared with 10% in Europe and 14% in America. Japan also came last in the International Institute for Management Development's rankings on entrepreneurship and second-last in the Global Entrepreneurship Monitor's ranking of early-stage entrepreneurial activity (defined as the proportion of people of working age who are involved in such activity). Why?

Cultural factors are a big part of the explanation. As a hoary old Japanese saying has it, “the nail that sticks out is hammered down.” Conformity is valued over individualism. “Students work hard at school, but they learn how to take tests, not how to think,” laments Sakie Fukushima of Korn/Ferry. And unlike American culture, which venerates the maverick self-made millionaire and is tolerant of failure, Japan frowns upon public displays of wealth and stigmatises business failure.

## On the outer edge

Take Takafumi Horie, an example of the sort of entrepreneur who remains extremely rare in Japan. With his characteristic jeans, sneakers and spiky hair, this self-styled rebel against Japan's corporate establishment transformed his internet start-up, aptly named Livin' On The Edge, into a vast conglomerate, which he renamed livedoor in 2004. At its peak, livedoor was worth some ¥930 billion ($8 billion) and owned an accounting-software firm, an internet travel agency, a securities house and a second-hand car business.

In 2005 Mr Horie mounted a takeover bid for Nippon Broadcasting System, a radio station, which would have given him control of Fuji Television, Japan's biggest commercial television station. The battle ended in a truce between Fuji and livedoor, but Mr Horie had infuriated the business establishment. In January 2006 raids on his home and office were broadcast live on television, and in March this year he was convicted of fraud and sentenced to two-and-a-half years in jail.

Mr Horie's critics regarded his use of elaborate financial engineering as evidence that pro-market reforms had gone too far; his supporters claimed that the attack on his empire had been orchestrated by Japan's corporate old guard. But his fate sent a clear signal to anyone who regarded Mr Horie as a new role model for Japanese entrepreneurs, says Hirotaka Takeuchi, dean of the school of corporate strategy at Hitotsubashi University. “He showed you can be an entrepreneur and be successful, but you shouldn't take it to excess. You've got to abide by the rules.”

In truth, Mr Horie was not the American-style capitalist people imagined him to be; indeed, the way he concealed the precarious financial state of his sprawling empire reeked of old-style Japanese book-cooking. But his behaviour served to reinforce the traditional Japanese scepticism towards showy entrepreneurs.

“If you stand out too much you become a target,” says Yoshito Hori, a venture capitalist and the founder of Globis Management School, a business school. That alone persuades many entrepreneurs to keep a low profile. But they face more than just cultural obstacles: the rigidity of the Japanese labour market makes life that much harder for them. Anyone who leaves a regular job for a start-up will find it difficult to get another job if the venture fails. And pensions are a particular problem: as Mr Masuda's example shows, people working for large companies are reluctant to leave their jobs in their 30s and 40s because they will lose their retirement benefits.

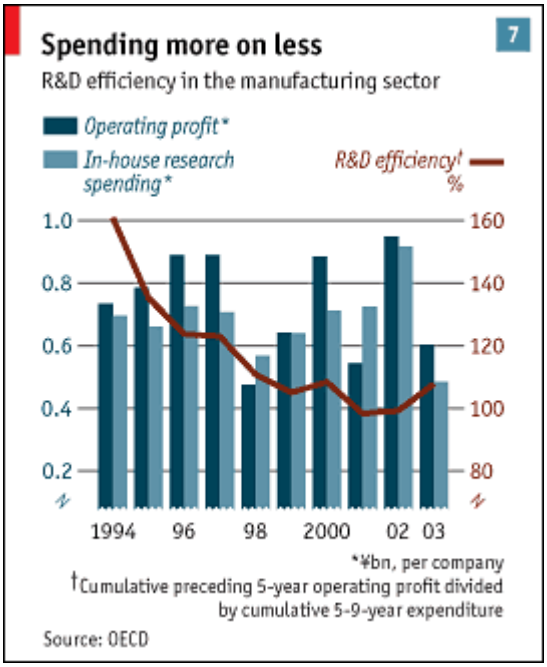
Other difficulties facing entrepreneurs include the lack of venture-capital funding, a dearth of knowledgeable angel investors, difficulty in hiring experienced managers and a lack of support networks, says Joichi Ito, an internet investor with experience both in Japan and in Silicon Valley. This forces some entrepreneurs to rely on foreign funding. “VCs and entrepreneurs are not as professional as they are in Silicon Valley,” says Sachio Semmoto, the entrepreneur behind a series of successful Japanese telecoms firms. Goldman Sachs, an American investment bank, put $25m into his most recent venture, whereas local Japanese venture funds contributed just a few hundred thousand dollars.

Given the innovative prowess of Japan's industrial giants, does it matter if start-ups have a hard time? The Economist Intelligence Unit, a sister company of this newspaper, ranked Japan first in a recent study of innovation, based on the number of patents awarded per million people. Japan generates 51% more patents than America in absolute terms, which works out at around 3.5 times as many patents per person. It also has more scientific researchers per million people (5,900 compared with 4,200 for America) and a higher research-and-development (R&D) intensity, at 3.4% of GDP compared with 2.8% for America.

But things may not be as rosy as these numbers suggest. Patents are an imperfect proxy for innovation; Japan's armies of researchers spend more time than their foreign counterparts on non-research activities such as administration, which reduces their effectiveness; and a report by the Cabinet Office found that the effectiveness of Japan's private-sector R&D—the ratio of operating profits to R&D expenditure—declined throughout the 1990s (see chart 7).

All this has fuelled concerns that Japan might now be on the wrong side of several trends. Japan's most famous innovations, such as the Sony Walkman and the Toyota Prius, originated in big companies. But the internet boom highlighted the vibrancy of the American way of innovating, in which a host of

entrepreneurial start-ups try out risky new ideas and the most successful of them either become, or are acquired by, larger firms. The American approach supports radical technological breakthroughs but depends on plenty of risk capital.




Akira Takeishi of the Institute of Innovation Research at Hitotsubashi University has investigated why Japanese firms are highly competitive in some industries (carmaking, electronics, imaging products, video games) and less so in others (personal computers, software). He concluded that Japanese firms did best in manufacturing industries with closed product designs that do not require collaboration with the rest of the industry, and worst in fields based on open standards and modular architectures. So if the nature of innovation has changed, and it now depends on collaboration with other firms around the world, Japan could be in trouble. Japanese patents with foreign co-inventors accounted for less than 3% of the total, compared with 12% in America.

Another worry is that Japanese companies concentrate too much on incremental innovations rather than radical breakthroughs. This served them well in the second half of the 20th century. But given the disruptive impact of the internet and the need for entirely new energy technologies to mitigate climate change, it may no longer be the right thing to do.

The government has formulated a series of plans and targets, including measures to boost international co-operation and increased funding for researchers in fields such as nanotechnology and clean energy, where breakthroughs could open up big new markets. It has also set about improving the climate for entrepreneurs and start-ups, for example by offering more favourable tax treatment for venture-capital investments, reducing the minimum capital requirement for new businesses to ¥1 and making it easier for start-ups to issue share options to staff.

## Land of opportunity?

One sign of progress is the higher turnover of new firms. Between 1997 and 2004 an average of 99 new companies a year were listed in Japan, up from 26 a year in 1981-89 and 36 a year in 1990-96. The number of delistings also rose, from four or five a year in the 1980s and early 1990s to an average of 41 a year in 1997-2004. This is due in part to the rise of second-tier stockmarkets such as Mothers in Tokyo and Hercules in Osaka, and the loosening of listing requirements on JASDAQ, which has made it easier for start-ups to go public. Mr Hori notes that there were 747 IPOs in Japan between 2001 and 2005, compared with 617 in America.

The slightly more flexible labour market has made it easier for start-ups to attract skilled workers. “Things are changing—people are coming out of big firms to join us,” says Mr Masuda, whose firm has hired engineers from JVC, Canon and other electronics giants. He says start-ups also offer more opportunities and better prospects to Chinese and South Korean engineering students in Japan: “We evaluate people for their skills, not their skins and eyes.”

Mr Hori goes so far as to suggest that start-ups have played an unacknowledged role in helping to turn around Japan's economy in recent years. He says the rebound was partly driven by the emergence of new companies in knowledge-based industries, led by entrepreneurs in their 20s and 30s. He points to Rakuten, an internet-shopping firm that now has a market capitalisation of nearly $6 billion, making it one of the largest internet-commerce firms in the world. Other Japanese success stories include DeNA, an internet-auction and shopping site, and Mixi, a social-networking site. Mr Ito is heartened by Japan's latest crop of internet entrepreneurs, such as Mixi's Kenji Kasahara. “The new generation of internet CEOs are very humble. They don't spend all their money in Ginza buying cars,” he says.

It seems that entrepreneurs can do well in Japan as long as they do not draw too much attention to themselves. Mr Hori thinks they have excellent prospects. There are still relatively few of them, and productivity in Japan's service sector is notoriously low, offering plenty of opportunities for start-ups. He says 70% of his venture-capital investments are in services companies, from nursing homes to wedding planning. Apart from services, says Mr Hori, “we are betting in areas where Japan has an edge,” such as

mobile technology, optics, robotics, digital animation and video games.

Despite these hopeful signs, however, some worries remain. One concern is that if economic growth strengthens and more full-time jobs are created, would-be entrepreneurs may be tempted to take the safer option of a job instead. Japan's recent wave of entrepreneurship, suggests Randall Jones at the OECD, was caused in part by the lack of job opportunities for talented graduates during the hiring freeze of the 1990s. But Mr Hori insists that times have changed, and “the best and brightest are now going into the entrepreneurial field, which has never happened before.”

Another concern is that too much government effort to encourage start-ups and promote innovation is concentrated on manufacturing and technology rather than services, which is arguably where change is most needed. To keep the momentum going, the OECD recommends reductions in capital-gains tax to encourage venture capital; more portable pensions and performance-based pay for researchers to encourage mobility between academia and industry; a broader educational curriculum; and the promotion of cross-border trade and investment, since good ideas often come from abroad. Changing Japanese attitudes to entrepreneurship will take time and further reforms, but at least the wheels have started turning.

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# Still work to be done

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Where he worked before, the traditional Japanese “lifetime employment” model was deeply entrenched. It is often said that this model is now collapsing and that the era of “jobs for life” has come to an end. But the reality is more complicated. For one thing, the traditional lifetime-employment system existed for only a few decades, and only at large Japanese firms; it was never universal. The system is now slowly crumbling, but only at the edges, notes Akira Kawamoto, the director of research at RIETI, a government think-tank. Most of the “salarymen” inside the traditional system will stay there until they retire. But the labour market is becoming more flexible in several ways.

Mid-career job changes, once unheard of, are no longer quite such a rarity. The strict seniority system is giving way to a greater emphasis on performance-based pay and promotion on merit. And the number of “non-regular workers” (a term that encompasses temporary, part-time and contract workers) is increasing. But much of this reflects efforts by Japanese companies to shore up the lifetime employment system for its “regular workers”, involving necessary concessions to keep the old system going. Useful though the reforms have been, they have also raised concerns about the growing inequality between regular and non-regular workers.

Under the traditional system, companies hired graduates and then invested heavily in their training and development. To keep workers loyal and protect their investment, they offered lifetime employment on steadily increasing pay, with generous fringe benefits and a lump sum on retirement. Employees worked their way up through the ranks, so age and seniority were tightly intertwined. This made it hard for people to switch companies in mid-career. Women who left to have children found they could return only to more junior, part-time positions. People competed fiercely for jobs at the best companies—but once they were in, their performance made no difference to their pay. “At Mitsubishi your salary went up by the same amount, no matter how hard you worked. My friends at foreign firms found this unbelievable,” recalls Mr Mori.

But this is now changing. Young people who start work at a big company no longer expect to stay there for their entire career. Some of them want more of a challenge, says Mr Mori; others “have seen what happens to people who move to another company and do well”. Foreign firms in Japan helped things along by poaching staff from Japanese firms, offering attractive benefits and better prospects for promotion on merit. “That creates more mobility,” says Mr Mori. “People hear success stories by word of mouth. If some people jump and become top managers, others want to do the same.” This is particularly noticeable in financial services, he says, but is spreading to other industries too. A common strategy is to start at a Japanese firm, move on to a foreign firm and then return to a Japanese firm in a more senior position.

## Signs of movement

A greater willingness to switch jobs also reflects declining confidence in the guarantee of lifetime employment, says Sakie Fukushima of Korn/Ferry, an executive-search firm. When she moved to Korn/Ferry in 1991, she says, on average only one in ten of the candidates she called was prepared to meet her. “Others would say they were not interested in moving or were scared by the term ‘headhunting'—we were thought to be industrial spies.” But after the dramatic collapse in 1997 of Yamaichi Securities, a securities-trading firm, there was “a huge change in psychology” as people realised that companies could fail. Today, she says, seven or eight out of ten people she contacts are prepared to meet her. “Many do not move, but they are interested to see what their options are.”

For their part, Japanese firms have become more willing to hire outsiders. With the fall from grace of the Japanese model in the 1990s and the increasing competitiveness of foreign firms, Japanese companies started to realise that they might benefit from outside expertise. There was also a “Carlos Ghosn” effect. When he first arrived at Nissan, Mr Ghosn was held in contempt by the corporate establishment. But within two years he had turned the company around, prompting a rethink among Japanese bosses.

More portable pensions have further increased labour mobility. Under the traditional Japanese system, employees qualified for a lump sum at retirement (over and above the state pension scheme) after 30 years at the same firm, which strongly discouraged mid-career moves. But some firms, most famously Matsushita, a big electronics manufacturer, have introduced a new scheme in which employees waive the lump sum at retirement in return for a higher salary. They can then put some of their extra pay into a personal pension plan, akin to an American 401(k), which they can take with them if they switch employers. This is particularly popular with women, says Mr Kawamoto. Workers who opt for it do not seem to be seen as disloyal. The tax system could be changed to encourage more people to use the scheme, he suggests: as things stand, the tax on traditional retirement income is low, but the tax treatment of portable personal pensions is comparatively ungenerous.

Performance-related pay has been another example of Japanese firms' experimentation with American ways of doing things. In some cases it started off as a form of wage restraint in the dark days of the 1990s: companies cut basic wages and employees hoped that performance-related pay might make up the difference, which it did not always do.

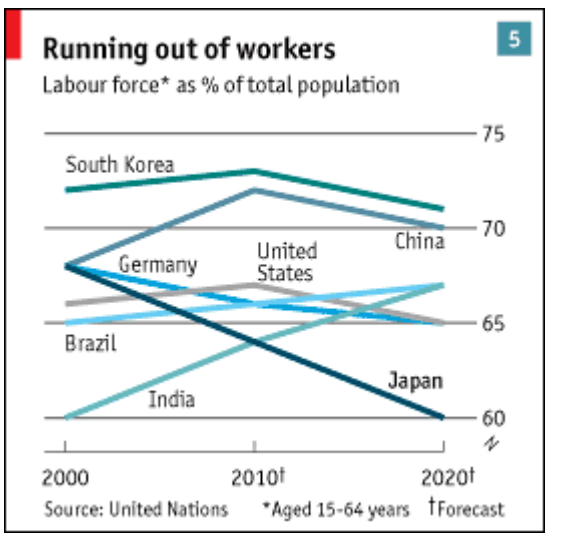
The idea met with stiff resistance. When Fujitsu, a Japanese computer giant, introduced a performance-based pay scheme during the 1990s, it proved so unpopular that the company had to scale it back. Managers found that workers became demoralised if they were not given above-average grades for performance—which, by definition, most could not be. NEC, another Japanese computer giant, introduced a similar programme and also had to modify it. Many firms now offer performance-based pay and other incentives, such as stock options, only to certain categories of worker, and keep the performance-related component small.

Along with performance-related pay has come a greater emphasis on meritocratic rather than seniority-based promotion. In recent years some firms have appointed younger chief executives, in their 50s, but many salarymen are unwilling to work under managers who are younger than themselves or who used to be their subordinates. Even within Sony, one of the most Americanised companies, old habits die hard. “I offered someone a senior job and he said: ‘But I'm only 48!',” says Sir Howard Stringer, the company's chief executive. “People thought seniority and skill were totally intertwined.”

As the labour market has become more dynamic for regular workers, however, the gulf between regular and non-regular workers has widened. When the recession took hold in the early 1990s, the idea that Japanese firms would make workers redundant was unthinkable. Instead, to maintain lifetime employment, companies held down pay and benefits for existing employees and stopped hiring new graduates. Spurred by changes to employment law, they also began to take on more non-regular workers on lower pay and short-term contracts. Whereas in 1994 non-regular workers accounted for only 19% of the labour force, the figure has since risen to 33%. This created a “lost generation” of graduates who were unable to get full-time jobs during the 1990s, got stuck in low-paid, non-regular positions in which no training was provided and found it difficult to move into regular employment.

There are different grades of people without regular employment. First come the “freeters” (a combination of “free” and *Arbeiter*, the German word for worker), those in temporary or part-time employment, whether by choice or necessity. Some freeters enjoy flitting between jobs, but many would prefer regular employment. According to a survey carried out in 2003, 40% of temporary workers and 22% of part-time workers said they would rather have a regular job but could not find one. Next are the NEETs (those “not in education, employment or training”) and the *hikikomori*, the twenty-somethings who withdraw from social life.

Most notorious are the so-called “net-café refugees”, an underclass of non-regular workers who cannot afford accommodation in the cities where they work and instead sleep in rented cubicles in internet cafés. A recent government report put the number of such “refugees” at some 5,400 nationwide. That is not a lot, but it highlights an area of growing concern: inequality was one of the issues on which the Democratic Party of Japan fought its successful upper-house election campaign in July which led to the downfall of the prime minister, Shinzo Abe.




The protection of regular workers, in short, has come at the cost of a growing army of non-regular workers. The irony is that companies that claim to be committed to lifetime employment can meet this commitment only by cutting back on hiring regular workers and relying increasingly on non-regular workers. “Toyota and Canon say they are still keeping lifetime employment, but to do so they are introducing a large number of non-regular workers,” says Keio University's Mr Seike. Canon, for example, now employs 70% of its factory workers on non-regular terms, up from 50% in 2000 and 10% in 1995. Non-regular workers typically earn half as much as regular workers for comparable work. About half of them are not covered by company pension or health-care schemes. But although the use of low-paid, non-regular workers reduces firms' costs, says Randall Jones of the OECD, it has the broader effect of constraining consumption, “so the expansion is still not firing on all cylinders.”

That said, as the economic recovery causes the labour market to tighten—unemployment hit a nine-year low of 3.6% in July—companies are starting to move some non-regular workers into regular positions. UNIQLO, for example, a clothes retailer, said in March that it would turn 5,000 of its 6,000 non-regular workers into regular ones within two years, and Canon said it would do the same for 1,000 of its 13,000 factory workers. Companies are also readier to hire workers in their 30s, particularly those with specific skills, says Mr Mori. That is helping to mop up some of the lost-generation freeters.

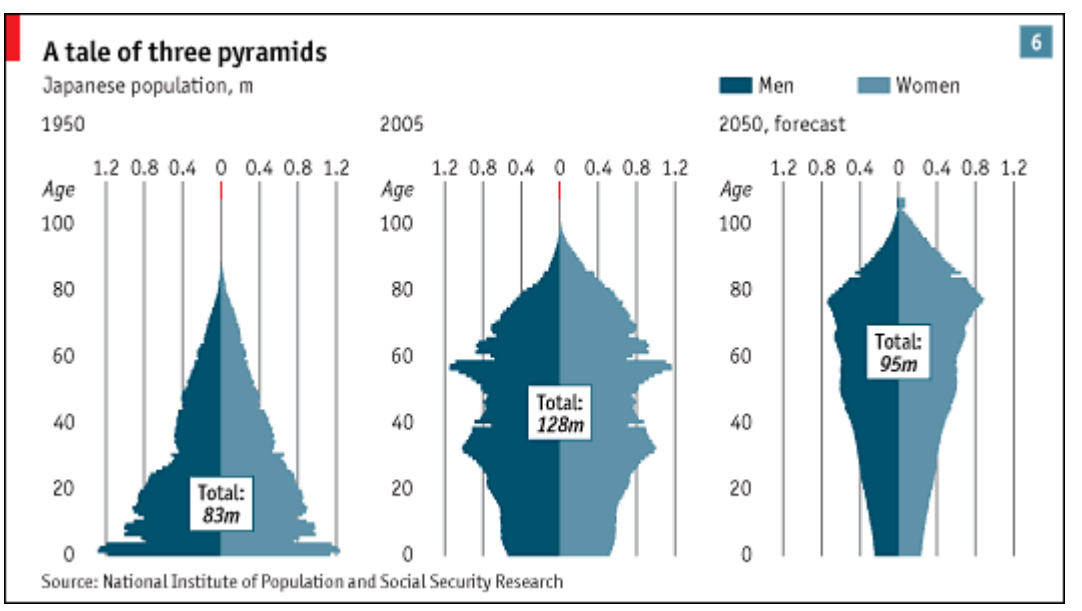
The danger remains that Japan will find itself with a generation of middle-aged workers with inadequate levels of training, says Mr Seike. What is needed, he says, is a scheme to encourage companies to invest in training those in their 30s, with some of the training costs provided by the government. But the best way forward would be to close the gap between regular and non-regular workers by reducing the pay and benefits of the first group and creating better conditions for the second.

## Tick, tick

The reform of Japan's labour market is being driven by the need to become more competitive and flexible in the face of global competition. But Japan also needs to tackle a longer-term threat: the ageing of its population. The share of its population aged 65 or over, currently 21%, will rise to 25% by 2014 and 36% by 2050. Japan's fertility rate has also been declining, hitting a low of 1.26 in 2005, though it has since risen slightly, to 1.32. But that is still far below the replacement rate of 2.1 children per woman. So as well as ageing, Japan's population is now shrinking. By 2030 Japan will have two workers for every pensioner; by 2050 there will be only 1.5. Large-scale immigration, the solution favoured in other rich countries, is not culturally acceptable in Japan. So it will have to put more women and old people to work in order to maintain its workforce.

To this end, the government has already passed a law requiring companies to raise their mandatory retirement age or provide retraining and re-employment for older workers. Most companies favour the second option: the seniority-based pay system makes the oldest workers the most expensive, so it is cheaper to offer them lower-paid work in semi-retirement than to keep them on as full-time employees.

Japan's elderly are still willing to work, unlike their counterparts in Europe, notes Mr Seike. In theory, older workers could be put to good use training their younger colleagues. Raising the retirement age to 70 would roughly halve the rate of decline of the workforce. Increasing the participation rate of women from its current level of 61% (versus 69% in America) would help even more. Japan's working-age population is expected to decline by nearly one-fifth by 2030, and boosting female participation would be the single most effective means of limiting the decline.




Many of the measures needed to do that, such as reducing the inequality between regular and non-regular workers and placing more emphasis on merit-based pay and promotion, would also improve flexibility more generally, notes Kuniko Inoguchi, who was minister for gender equality under the Koizumi government. But other measures that would specifically benefit women, such as better provision of child-care facilities, are also needed. Only 33% of children between the age of three and the mandatory school age (six in Japan) are in formal child care, compared with the OECD average of 73%. New rules for corporate child-care schemes and maternity leave for non-regular workers came into force in April. Big companies tend to offer child-care facilities already, but 90% of women in jobs work at small firms, which need to be persuaded to follow suit, says Ms Inoguchi.

Japan is doing its best to combine the stability and equality of its old labour-market system with the dynamism of the new. But as it becomes clearer that conditions for non-regular workers need to be improved and more women have to be encouraged to enter the workforce, the crumbling of the old system will accelerate.

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# JapAnglo-Saxon capitalism

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From The Economist print edition

Illustration by Jac

**Have Japanese business practices changed enough?**

TO AN observer watching a Toyota Prius drive by, the car's hybrid propulsion system is invisible, but its improved performance shows up clearly in its fuel-consumption figures. The same applies to Japan's new hybrid industrial model. Outsiders cannot always tell how much a particular company has changed the way it does things. But the improvement in Japan's economic performance is clear, and at least some of it is due to the adoption of the hybrid model.

“Japan has both embraced and rejected American capitalism,” observes Mr Vogel of the University of California, Berkeley. Having identified the American style of capitalism as a possible model, Japan's business leaders were highly selective about which aspects of it to adopt, he says. Under the resulting hybrid model, Japanese companies may well maintain close co-operation with employees yet at the same time profess support for shareholder value; remain committed to lifetime employment but also offer merit-based pay and share options; and engage more fully with the global economy yet keep certain activities in Japan and replicate some Japanese practices even in foreign markets.

How prevalent is the hybrid model? Gregory Jackson, an expert on international comparisons of corporate governance at King's College London, and Hideaki Miyajima of Waseda University analysed data on 723 Japanese companies gathered by the finance ministry and identified three clusters: 24% had adopted hybrid models; 42% were traditional Japanese firms; and the other 34% were somewhere in-between.

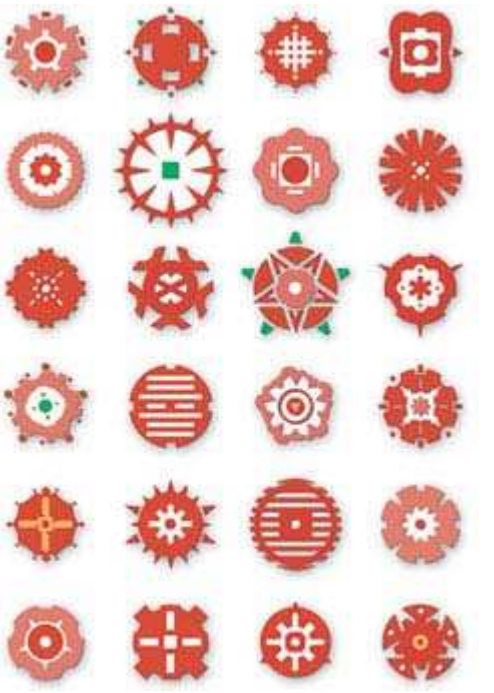
Of the firms with hybrid models, 94% offered lifetime employment, 45% merit-based pay and 39% employee stock options. These companies were more likely to have outsiders on the boards than traditional firms, made more use of corporate bonds as a source of finance and less use of banks, and had a high level of foreign or institutional share ownership. This group included many large, internationally oriented firms, such as Toyota, Canon, Yamaha, NTT DoCoMo, Hitachi and Mitsubishi. Toyota, regarded as an archetype of corporate Japan in many respects, is a typical example: it has switched from bank financing to bonds, has a high level of foreign ownership and has introduced stock options. But it remains committed to lifetime employment and has resisted putting outsiders on the board.

All of the traditional Japanese firms offered lifetime employment and none merit-based pay; 19% awarded employee share options. They generally had boards consisting entirely of insiders, relied on bank finance rather than bonds and had few foreigners and institutional investors holding their shares. They were typically involved in industries such as construction, chemicals, textiles, machinery and food. Companies in the third cluster retained traditional ownership and finance structures, but some firms had adopted more market-oriented employment policies. Firms in this group included retailers, technology firms and family-controlled companies in a variety of industries.

On average, notes Mr Jackson, hybrid companies performed significantly better (measured by return on assets) than traditional Japanese firms or those in the intermediate group. Evidently the hybrid model allows firms to bring their distinctive competitive strengths to the wider world. And although they accounted for only 24% of Japanese firms, this included a disproportionate number of Japan's industrial giants, so the hybrid cluster accounted for 67% of the workforce.

This raises the question of how stable the hybrid model is, and whether it is just a step on the way to a total embrace of the Anglo-Saxon model. Mr Jackson points out that the number of companies introducing the American-style committee system has begun to slow and the debate on corporate-board reform has cooled. Now that the economy has started to recover, the decline in cross-shareholdings has halted and even gone into reverse. All of this, he suggests, implies that the hybrid model is stable, and will not prove to be just a halfway house on the way to an American model.

Illustration by Jac



## Halfway to America

“We don't have to go all the way to America,” says Yukio Yanase, deputy president of Orix, a financial-services firm whose founder, Yoshihiko Miyauchi, is a strong proponent of more American-style corporate governance. “At Orix we often say: ‘Let's go to Hawaii.' It lies in the middle,” explains Mr Yanase. Appropriately enough, Orix is listed in both Tokyo and New York, and half of its board members are outsiders.

The idea of a middle way that can act as a model for other countries is seductive. “A lot of Asian countries are saying: ‘We hope Japan will succeed, so we have a new model that combines capitalism with social values',” says Hirotaka Takeuchi of Hitotsubashi University. Does that mean it is something like the European model? Yes, but not identical, because taxes are lower and the state is smaller in Japan—and unlike in France, Germany or Scandinavia, companies provide a lot of social support.

Another difference with many parts of Europe is that in Japan business is regarded as a respectable pursuit that provides social goods rather than a necessary evil, notes Mr Marra of A.T. Kearney. But he thinks taking the middle way would be a mistake. Unless it becomes more like America, he argues, Japan risks ending up like Switzerland: comfortable and complacent, but irrelevant. Japan is undoubtedly changing, he argues, but not fast enough.

Other Japan-watchers express similar concerns. Japan may be the world's second-biggest economy and may represent around half the entire Asian economy, but it could yet become an economic backwater as America and Europe focus instead on China, says Mr Jones of the OECD. The danger is that having bypassed Japan since the early 1990s, foreign companies might not even notice that the Japanese economy is recovering. Mr Porté of Shinsei Bank says faster reform is needed because Japan is changing more slowly than the rest of the world. “China and India are changing very rapidly, so we need to be concerned about keeping up with all of that,” he says. “The job is not finished, but we risk being stuck.”

Kuniko Inoguchi, a member of parliament and a former minister in the Koizumi government, does not think that the pace of reform has slowed. Instead, she says, the focus has shifted to fine-tuning the impact of the reforms. There is no question of backsliding, she insists: “companies now see there is no way to go back” and are continuing with their own programmes of internal reform.

Mr Vogel goes further, arguing that Mr Koizumi's influence has been overstated and that his departure does not mean that change has halted. “The most important reforms are technocratic things that just plod along, so that process will continue,” he says. He even argues that it is dangerous to reform too fast, and that Japan has been sensible to adopt reforms in a selective, incremental way.

Where will corporate Japan be in a decade's time? The optimistic scenario, says Mr Chhor of McKinsey, is that Japan's hybrid model will enable it to re-emerge as global leader, driving progress in electronics and environmental technology in particular. “That would provide the country with the vitality to address the two-Japans challenge,” he says, referring to the divergence between rich and poor, global and local companies, pensioners versus workers, regular and non-regular employees, and rural and urban communities.

The pessimistic scenario is that the slow grind of reform will continue, but without providing enough growth to enable the government to tackle the country's huge debt as the population ages and the tax base shrinks. “I am concerned that we'll have slower growth and weak consumption, and that Japan's problems will simply become exacerbated,” says Mr Porté. He is particularly concerned that Japan's brightest youngsters may leave

the country in search of better opportunities.

The actual outcome will probably be somewhere in-between: a slow muddling-through, suggests Gerald Curtis of Columbia University. But there are two things that could change the picture dramatically. The first is that the demographic shift and the resulting labour shortage might actually help to spur faster reform and new technological developments. “Rather than being the biggest threat, the retirement of the boomers is the biggest opportunity,” says Mr Takeuchi.

## Out of misfortune

When Japan is faced with a crisis, it often responds by devising new technologies, he notes. “So this will be a big impetus for Japan to move into robotics, nanotech and so forth to replace manpower. I'm really looking forward to it.” Atsushi Seike of Keio University recalls that Japan has successfully adapted to big changes in the past. And he points out that China and South Korea also have ageing populations, though they are further behind—so if Japan can solve the problem, it could provide a model for those countries.

The second intriguing possibility is that the pace and nature of technological change might shift in Japan's favour. It is clearly less successful than America in producing internet start-ups and software companies. But if the next big technological wave involves clean-energy technology, as seems likely, Japan could have an advantage. Once it is a matter of incrementally refining new energy technologies and manufacturing them in vast quantities, Japan will be very well placed. After all, it is already the leading manufacturer of hybrid cars and solar panels.

Inevitably, Japanese observers tend to stress how far their country has come over the past decade, while foreigners emphasise how far it still has to go. Yet there is general agreement that reform will continue; that the hybrid model will be developed further and refined as more companies adopt it; but that this does not mean Japan will drop its way of doing things in favour of an all-American approach.

Look at the Toyota Prius again. Its hybrid design is also being refined. The next version, due in 2010, will be a “plug-in” hybrid with a better battery pack that will be able to make short trips entirely on electric power. Toyota's Mr Cho says he has recently ridden in a prototype, “and believe me, it's wonderful.” The hybrid design will also form the basis of cars powered by fuel cells. To be sure, some people think cars should simply go all-electric, just as some people think that Japan should go all-American. But there are plenty, too, who believe that the future is hybrid.

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# Sources and acknowledgments

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Telecoms in India

# Full-spectrum dominance

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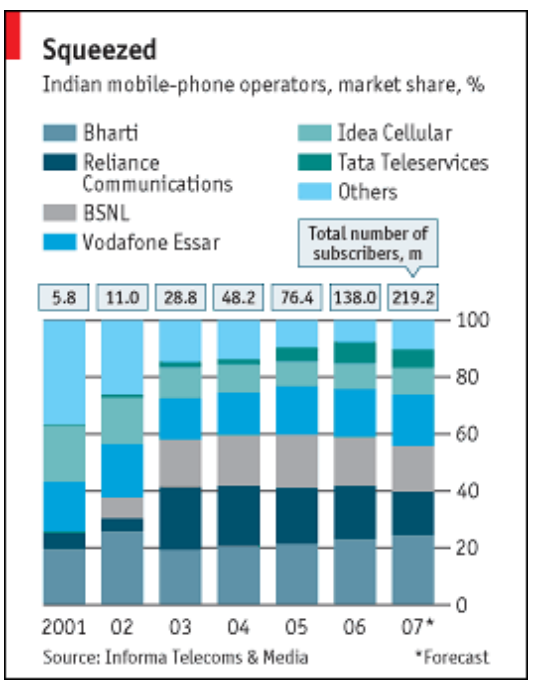
EPA

**India's fast-growing mobile-phone operators vie for capacity on the airwaves**

MUMBAI's trains are famous for carrying what is officially called a “super-dense crush load” of passengers during rush hour. Judging by the complaints of some of India's mobile operators, its airwaves are just as overcrowded. The operators added more than 8m mobile-phone subscribers in October, bringing the total to over 217m. India has met its ambitious target, set two years ago, of 250m fixed and mobile-phone connections. But the government is sadly unprepared. It has not given India's mobile operators enough space on the radio spectrum to carry calls crisply and reliably. India, the operators complain, faces a “spectrum crunch”.

In November Sunil Mittal, the chairman of Bharti Airtel, wrote to India's telecoms secretary describing the “extreme anguish” caused by the “pitiful” amounts of spectrum granted to operators using GSM technology, the dominant standard that is used by three-quarters of Indian subscribers. The government had said it would provide extra spectrum to firms once they had amassed enough subscribers. Airtel, for example, was supposed to receive an additional allotment in Delhi once it passed 1.6m subscribers. It now has over 3.6m and is still waiting.




The speed of mobile telephony's spread has caught the telecoms regulator by surprise. Its engineers have proposed raising the subscriber thresholds at which GSM operators are granted more spectrum, in some cases increasing them 15-fold. Operators are outraged. Efforts are now being made to reach a compromise.

One operator that agrees with the regulator is Reliance Communications (RCOM), which serves 39.4m subscribers, mostly using a rival technology called CDMA. Its chairman, Anil Ambani, now wants to start offering GSM services across the country. In October RCOM paid 16.5 billion rupees ($418m), a price that has not changed since 2001, for a new GSM licence. Having joined the queue of licence-holders awaiting “start-up” spectrum, Mr Ambani thinks the incumbents already have more space than they deserve. Their demands for another helping will only deprive new entrants (such as himself) of the spectrum they need to compete, he argues.

Mr Ambani can be persuasive. But nobody can claim India's mobile-phone market lacks competition. Kunal Bajaj of BDA, a telecoms consultancy, thinks that when the GSM incumbents bought their licences after 1999, they had some right to expect further allocations of spectrum as their subscriber bases grew. Paying 16.5 billion rupees for a licence in 2001, before India's market took off, was a much bigger gamble than paying the same sum now.

How much damage will the impasse do to Indian telecoms? In a recent presentation, the regulator's technical advisors compared “dire predictions” about the scarcity of spectrum to Thomas Malthus's grim prognostications in 1798 about the scarcity of food. Just as Malthusians were wrong to assume that the productivity of crop-land was fixed, so pessimists are wrong to assume that a unit of spectrum can support only so many subscribers. If spectrum is tight, operators will find ingenious ways to squeeze more out of it, the engineers reckon, using new technologies such as smarter antennae. Like Mumbai's commuters, who hang from carriage doors and windows, the GSM operators should tuck in their elbows and make more use of the available space.

This argument exasperates Airtel's Mr Mittal. GSM companies are already spending heavily to cope with the congestion on their networks, by building their towers closer together, for example. If it is so easy to economise on spectrum, Mr Mittal says, then perhaps the government's own phone companies, BSNL and MTNL, would like to surrender some of their spare capacity and show the rest of the industry how to make do with so little.

One way to squeeze more calls into limited space is to reduce the quality of service. The over-grazing of India's spectrum is already beginning to show in dropped calls and patchy reception. In India's two biggest cities, Delhi and Mumbai, the quality of service is “beyond horrible”, says Mr Bajaj. Calls are often disconnected, especially if a “mobile” subscriber is presumptuous enough to walk while he talks.

If there is no easy technical fix for India's phone squabbles, there may, however, be a military one. India's armed forces, as well as its railways and space programme, hog an unduly large amount of spectrum, doled out to them when the radio waves were as sparsely populated as the Himalayan peaks. The military, unsurprisingly, has been reluctant to release its grip on this spectrum. But the government hopes to prise some from its hands by the end of the year. The telecoms regulator has even suggested that public bodies should pay market rates for their spectrum, just as they must pay for labour and capital. That would force them to treat spectrum as a scarce resource, not a state entitlement.

The government has also earmarked space in the spectrum for “third generation” (3G) networks, which use more advanced technology to pack in more calls, as well as making possible fancy data services. It has not decided when to dole out this bandwidth, but plans to auction 3G licences to all comers, ignoring the regulator's recommendation that only existing phone companies should be allowed to bid. Even so, the most eager offers are likely to come from familiar faces, who will be able to move their most demanding and affluent customers onto the 3G bands, leaving more room for their poorer compatriots behind them.

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Airlines

# Pie in the sky

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From The Economist print edition

**There is no Spanish or Italian solution to the problems of Iberia and Alitalia**

FOR all the brave talk of liberalisation, the airline business has yet to escape the bane of economic nationalism. American airlines will still be out of bounds to foreign ownership when the new “open skies” agreement with Europe comes into force next April. And within the European Union, although such obstacles officially do not exist, the reality is rather different.

This week a €3.4 billion ($5 billion) consortium bid for Iberia, the Spanish “flag carrier” by British Airways (BA), Texas Pacific Group and three Spanish private-equity firms crumbled in the face of political resistance. Caja Madrid, a savings bank controlled by Madrid's regional government, raised its stake in Iberia to 23.3%. The move was designed to force BA, which owns 10%, to exercise pre-emption rights and raise its own stake, or back off. Having promised not to spend BA's cash on the bid, Willie Walsh, its chief executive, had no option but to retreat.

Meanwhile on December 5th Alitalia, Italy's national airline, hopes to receive non-binding offers for most of the Italian government's 49.9% stake. It may be disappointed. Alitalia, which loses about €1m a day, is a very different proposition from Iberia, which is decently managed and modestly profitable. But its fate also lies in the hands of politicians rather than those appointed to run the business.

Having made a basket-case of Alitalia through years of interference, the Italian government doomed a previous attempt to auction its shares last July by imposing a string of conditions, including requirements to maintain bloated staffing levels (cabin crew work less than 10 hours a week), keep open loss-making routes, retain Rome as a hub airport and preserve Alitalia's national identity. This time round, the conditions of sale are said to be less onerous, but so far the only airline that looks almost certain to bid is Air One. Despite being Italy's second-biggest carrier, it is a relative tiddler with revenues last year just one-eighth of Alitalia's. Air One has political support and the backing of Italy's second-biggest bank. But industry observers reckon that Alitalia has little future outside the sheltering embrace of one of the big three European network carriers—Lufthansa, Air France-KLM or BA.

The same is true of Iberia, even though it is much healthier. Its domestic and short-haul routes, like Alitalia's, are under relentless attack from low-cost competitors such as Ryanair and Easyjet. And the final section of the Madrid-Barcelona high-speed rail link is about to open, depriving Iberia of Europe's most profitable route. Innovata, a provider of travel-industry data, says that since 2002 Iberia's domestic market share has fallen from 59% to 32%, and Alitalia's from 52% to 40%.

Iberia's chairman, Fernando Conte, is a realist who advocates further consolidation. He would have welcomed a tie-up between Iberia and BA if it could have been done speedily and on the right terms. The two airlines are members of the same alliance and co-operate on a number of routes. BA says it is not too sorry to have failed to bag Iberia. But its hope for business as usual is probably forlorn. Iberia will eventually have to find a partner with scale and financial clout. Lufthansa, which has far less overlap with Iberia's lucrative Latin American routes than Air France-KLM does, seems the likeliest candidate.

Nor is there an Italian solution to Alitalia's plight, whatever politicians imagine. Nick van den Brul of Exane BNP Paribas points out that although the Italian business-travel market is booming, the only value in Alitalia itself is “option value” contingent upon a purchaser's ability to do whatever is needed to turn the business around. With net debt of around €1.2 billion, an elderly fleet and at least ten stroppy unions to deal with, any potential buyer—Air France-KLM says it is still interested—will want the Italian government to take on some of the risk. When will reality bite? That is the awkward question for the meddling politicians of Italy and Spain.

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E.ON and RWE

# Damned duopoly

Nov 29th 2007 | FRANKFURT
From The Economist print edition

**Love them or hate them, Germany's two power giants keep the lights on**

IN AN apparent victory for the little man, the burghers of Ensdorf this week successfully blocked plans by RWE, a huge German power company, to build a spanking new coal-fired power station in their back yard. But those Saarland villagers have won an incomplete victory. Germany needs to add about 35,000 megawatts (MW) of new capacity by 2020, plus another 16,000MW if its nuclear plants are to be phased out by then, as planned. So new power stations will have to be built somewhere.

RWE and E.ON, the other German power giant, are treading on eggshells these days. Their duopoly over electricity generation and distribution in Germany is under attack from almost every quarter: the European Commission, the Federal Cartel Office, the Federal Network Agency and, of course, consumers. People are livid that the two giants recently announced price rises of 7-10% for next year, despite record profits in the first three quarters and windfall gains from $CO_2$ emission certificates that they were given free.

On top of that, RWE has been fingered, in a report by PricewaterhouseCoopers, as the biggest carbon emitter in Europe among power producers; E.ON is number three. Part of the reason is that other countries, especially France, rely more on nuclear power and hydro-electricity. Germany has the highest share of wind farms in Europe, but they still provide only 4.8% of production.

The European Commission is on the warpath against E.ON for a suspected secret agreement with Gaz de France not to compete for sales on each other's territory, and against RWE for allegedly discouraging competitors from using a gas pipeline across southern Germany. A commission report also indicates surprising rises in German electricity prices, compared with the rest of Europe; and it is threatening to order the separation of European power producers from the power networks they operate.

From January 1st the German Cartel Office will have stronger powers to intervene on pricing by the power giants, assuming that a bill passed by parliament is ratified. In any official inquiry, the producers will have to prove that their prices are reasonable—and they will be unable to hinder the investigation using court injunctions. The Cartel Office has been encouraged by a recent court ruling in Dusseldorf, which barred E.ON's purchase of some municipal power capacity on the grounds that “the electricity market in Germany is dominated by a duopoly”. And the Federal Network Agency, which oversees energy distribution and telecoms networks, has high hopes for a regulation that came into force in July, requiring power companies to operate their networks as separate companies, which could boost competition.

Wulf Bernotat, boss of E.ON, believes the campaign has gone too far, and grumbles that one politician likened the power giants to the Mafia. RWE and E.ON are fighting back, lobbying hard in Brussels and Berlin, and hiring the odd politician to help: Wolfgang Clement, economics minister in the last government, is on RWE Power's board. And RWE recently installed Jürgen Grossmann as chief executive, replacing Harry Roels, despite buoyant results. Mr Roels was said to care too much about shareholders, whereas Mr Grossmann has more clout with politicians.

As for the high consumer prices, the two giants blame this unconvincingly on taxation, past contracts sold at low prices, and investment in renewable energy, which is supposed to provide 20% of capacity by 2020. But profits of €2.8 billion ($4.2 billion) at RWE and €5.8 billion at E.ON in the past three quarters make those arguments sound a little hollow.

So do protests that the duo's influence has only a small influence on traded German electricity prices. Together with Vattenfall and EnBW, they account for 90% of German electricity production. Most of this power is bought and sold behind the scenes. EEX, the energy exchange in Leipzig, handles only 9% of German electricity trading, though another 15% is cleared there in the form of over-the-counter trades. For other electricity trades, done either directly or through brokers, no prices or volumes are published. Attempts to get more of these deals traded on (or at least reported to) EEX have largely failed. Another concern is that the giants have an inherent advantage, given the second-by-second sensitivity of the electricity price to the availability of power. They can more easily juggle different sources to increase supply when the spot price shoots up.

RWE and E.ON are investing heavily and noisily in renewable energy. Mr Grossmann recently said he would spend €1 billion a year through a separate renewables division, called RWE Innogy. E.ON, in a consortium with Royal Dutch Shell, plans to build one of the world's biggest wind farms off the British coast. But these efforts will not change the reality that with nuclear power off the table, most new German power capacity will have to come from dirty old coal. If other communities follow the example of Ensdorf and block new coal-fired stations, the lights will eventually go out.

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Philips

# Bright idea

Nov 29th 2007
From The Economist print edition

**Low-energy illumination is lighting up the Dutch electronics giant**

THIS weekend the Italian village of Torraca proclaims itself the world's first “LED city”, unveiling new streetlights that emit a bright, white and ecologically green glow. The new lights use light-emitting diodes (LEDs), which are winning favour over incandescent bulbs for interior lighting because they use only one-eighth of the power, stay cool and last for up to ten years. All this also makes LEDs an attractive alternative to the baleful orange glow of traditional sodium streetlights.

Torraca's new lights have been installed by an Italian start-up, Elettronica Gelbison, which makes components for cars—a growth market as the volume of electronics in each vehicle increases. Many cars already have LED tail-lights; headlights will be next as LEDs increase in power and new applications open up. The Torraca project is the first example of LED streetlighting, and a beacon for the new wave of “clean-tech” innovation that is attracting investors just as early computers did a generation ago.

The rise of LEDs is giving birth to new firms such as Gelbison, but is also affecting the giants of the world's electronics industry. Philips, Europe's biggest electronics company and a world leader in lighting, this week bought an American firm, Genlyte, for $2.7 billion, its fifth acquisition of a lighting firm in recent months. Philips has said that it has as much as €20 billion ($29.7 billion) to spend on acquisitions. It hopes to use Genlyte's relations with distributors and retailers to increase sales of LED lighting in America. The deal makes Philips the biggest lighting firm in the American market, ahead of General Electric.

The Genlyte acquisition is the group's biggest since it started reshaping itself from a sprawling conglomerate into a business built around three pillars: health care, lighting and consumer products. Philips hopes the reorganisation will enable it to double earnings-per-share by 2010 and increase margins through innovation and acquisitions.

Lighting is particularly attractive to Philips, because the revolution triggered by LEDs is changing the whole industry. Lighting is becoming integrated into interior design, making neon strips and incandescent bulbs look as old-fashioned as black-and-white television. LEDs can be implanted into furniture or walls and can even change colour. Torraca's new lights should earn the town a place in history, alongside Holborn Viaduct in London, where the first electric streetlights were deployed in 1878.

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Web metrics

# Many ways to skin a cat

Nov 29th 2007 | SAN FRANCISCO
From The Economist print edition

**Such a lot of data, so little information**

IMAGINE you are an advertiser, you want to place your banners on the most popular website, and you want to know how much to pay. Globally, the leading site is Google, which has the most “page views”. Or is it Microsoft, whose various sites have, in the jargon, the most “time spent”? Or should you go by unique users, duration, hits, click-through, impressions, queries, sessions, streams, or engagement? Whether or not there is truth in advertising, there is certainly none for online advertisers, at least none that is immediately obvious and simple. Bob Ivins, who is in charge of all non-American business for comScore, a big web-measurement firm, says that the web produces data as “a fire-hose shoots water”, and that working out what those data mean is rather like “putting a straw into the fire hose to take a sip”. Get the angle even slightly wrong, and you are blown away.

**Page ranks**

Worldwide top ten websites, September 2007

| Rank | Unique visitors | Time spent | Page views |
|---|---|---|---|
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| 2 | Microsoft sites | Yahoo! sites | Yahoo! sites |
| 3 | Yahoo! sites | Google sites | Microsoft sites |
| 4 | Time Warner network | Time Warner network | Fox Interactive Media* |
| 5 | eBay | Fox Interactive Media* | Facebook |
| 6 | Wikipedia | eBay | eBay |
| 7 | Fox Interactive Media* | Facebook | Time Warner network |
| 8 | Amazon | Tencent | Tencent |
| 9 | Apple | Lycos sites | Lycos sites |
| 10 | CNET networks | SINA Corporation | Baidu.com |

Source: comScore *Includes MySpace

Take, for instance, the case of page views, the most widely used measure for much of the past decade. It is the number of times web surfers call up web pages on a given site. Page views became popular in the late 1990s, because they were far superior to the existing measure of “hits”, also known as “file requests”. Hits are confusing because every graphic on a page, as well as the page itself, counts as a hit. If a site owner puts more graphics on his pages, he gets more hits, even if visitors, clicks and everything else stay the same. “We produced hits numbers because we could, not because it was useful,” says one old-timer in the industry.

By comparison, page views do actually mean something, and are easy to comprehend by analogy to the offline world to boot—many advertisers are still used to counting pagination in magazines. So everybody started paying attention to page views. But then something odd happened. Page views at certain kinds of websites, especially the more sophisticated sort, began to decline, even though the site appeared otherwise healthy and popular.

The explanation has to do with “Web 2.0”, and more specifically with a constituent technology called “asynchronous JavaScript and XML”, or AJAX. This is a method that lets web pages update parts of themselves—a share-price ticker or an e-mail inbox, say—without having to reload and redraw the rest of the page, resulting in web pages that behave less like documents and more like pieces of software. But this means that a user of an AJAX page, such as Yahoo! Mail or Yahoo! Finance, can spend the entire day working on the same page, and this activity counts as only a single page view.

Perhaps advertisers should therefore ditch page views in favour of “user sessions”, since that promises to count actual people, and show how many of them use a site. Except that it doesn't, because this measure counts browsers rather than humans. So 2m sessions could mean, theoretically, that 2m people visited a site once, that 1m people visited twice, or that one astonishing individual visited 2m times. People tend to check their favourite pages in the office, at home, and even from their mobile phones, which leads to an overestimate of the number of users. Conversely, sometimes several people watch YouTube clips when gathered around the same screen, which leads to an underestimate of the number of users. Nobody looking at user sessions would ever know.

As websites, and especially those using AJAX, become more interactive, advertisers are therefore interested in other measures. “Duration” and “time spent”, for instance, suggest how long one or more people were interacting with a page, which in turn hints at how “engaged”, or alert, they were. Using these criteria, social-networking sites such as Facebook and MySpace (part of Fox Interactive Media in the chart) suddenly look attractive.

In the old days of traditional media, measures may have been simpler, but they were also dumber, says Randall Rothenberg, the boss of the Interactive Advertising Bureau, a trade association. In broadcast television or radio, firms such as Nielsen or Arbitron traditionally give gadgets to samples of volunteers that measure what their televisions or radios are tuned to; or they ask people to fill out diaries describing their reading, listening and viewing habits. Both methods produce notoriously unreliable estimates.

The web is an open book compared with those old media. Search advertisements, the text links on the results pages of search engines, charge advertisers only when a user actually clicks, thus expressing an interest. “Pre-roll” advertisements that run at the start of a web video report back exactly how many times they were viewed. But when it comes to banner advertising, says Mr Rothenberg, advertisers just have to consider all these new measures as they would a pointillist painting by George Seurat: looking at one dot is no fun; taking them all in can be rewarding.

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Corporate governance in America

# Shareholder rights and wrongs

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There have been many efforts over the years to improve America's system for electing corporate directors. As things stand the incumbent board sends shareholders a ballot, or proxy, listing its preferred candidates. Any shareholder wishing to propose an alternative slate of directors must bear the cost of distributing a rival proxy. An attempt in 2003 by William Donaldson, then SEC chairman, to allow shareholders to nominate directors on the company proxy was shelved when bosses objected.

Shareholder activists then hit upon a strategy that, it seemed, bosses could not block: voting to change company bylaws to allow contested elections on the official proxy. Surely a board cannot object to shareholders voting on company bylaws? The board of AIG, a big insurer, thought it could. The matter went to court, and the SEC was asked to decide.

The SEC, now led by Christopher Cox, was split, and put two possible rules out to consultation. But then one of the SEC commissioners nominated by the Democrats left, leaving the pro-boss Republicans able to win the vote. Mr Cox plans to return to this issue when he has a full bench of commissioners, but do not expect anything to happen soon.

The bosses insist that they are actually lobbying to protect the interests of shareholders as a whole against minority shareholder activists, especially hedge funds, unions and campaigning, single-issue investors. This is nonsense. The fact is, even with proxy access, dissident shareholders would need to secure the votes of a majority of shareholders to change the board. If the majority disagrees with the minority, then it can vote the other way. That is shareholder democracy, and in most other developed countries constitutes part of what it means to be an owner of a public company. In those countries, it is extremely rare for board elections to be contested, and rarer still for dissident shareholders to succeed in getting their candidates elected. What are American bosses so afraid of?

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Diamonds

# Culling Cullinan

Nov 29th 2007 | JOHANNESBURG
From The Economist print edition

Petra Diamonds

**Not time to stop digging just yet**

## De Beers sells one of its most famous mines

RICHARD BURTON probably knew nothing of the small South African town of Cullinan when he bought yet another chunky diamond for Elizabeth Taylor in 1969. But the rock, still known as the Taylor Burton, was found there, together with a quarter of the world's diamonds over 400 carats. The Cullinan mine has also produced what is still the largest rough gem in the world—the whopping 3,106-carat Cullinan Diamond—parts of which adorn England's Crown Jewels. Now the mine itself, like so many of the diamonds unearthed there, is about to change hands. On November 22nd De Beers, the diamond giant that has owned the mine since 1930, said it was selling it to a consortium led by Petra Diamonds, one of South Africa's emerging diamond producers, for 1 billion rand ($147m) in cash. Provided regulators approve the deal, the transfer should take place by the middle of next year.

De Beers is selling because the mine is no longer profitable, despite attempts to turn it around. But Petra reckons the mine still has another 20 years of production in it and plans to extract at least 1m carats a year. The unexploited “Centenary Cut” deposit, which lies under the existing mine, could yield a lot more. This is good news for the mine's 1,000 or so employees and for the town, which has depended on the diamond business since Sir Thomas Cullinan discovered a prospect there in 1898 that contained kimberlite, a rock that can be rich in diamonds. The mine, established in 1903, is one of 30 or so kimberlite diamond mines in the world, and is believed to be still the world's second-most-valuable diamond resource.

Petra is a relatively small outfit, listed on London's Alternative Investment Market, that specialises in buying mines that bigger companies see as marginal. Its trick is to extract better returns by rationalising production and processing, and keeping operating costs and overheads down. Petra has already bought two of De Beers's loss-making South African mines—both of which are now profitable—and is finalising the 78.5m rand acquisition of the group's underground operation in Kimberley (the town that gave kimberlite its name), which stopped working in 2005.

It already operates four mines in South Africa and has promising exploration in Angola (a joint-venture with BHP Billiton), Sierra Leone and Botswana. Petra expects to produce over 1m carats by 2010—quite a jump from 180,474 carats in the year to June. The company has yet to make a profit, but expects to be making money by the middle of next year.

In the 1990s De Beers decided that it was no longer a good idea to try to monopolise the diamond market. It started focusing on higher returns rather than market share, and has been revamping its mine portfolio, selling off mines that are no longer profitable and investing in more enticing operations, such as its mine off the west coast of South Africa, its Voorspoed operation in the Free State province, and two new mines in Canada.

This has opened the way for a new class of diamond firm that operates in the vast middle ground between the world's handful of large producers (De Beers, BHP Billiton, Rio Tinto and Alrosa) and a multitude of much smaller exploration firms. The Cullinan deal should entrench Petra in this middle tier, alongside firms such as Kimberley Diamond and Trans Hex. But even if it does reach its target of 1m carats a year, Petra will still not be able to match the sparkle of the giants. Last year De Beers produced 51m carats from its mines in Botswana, Namibia, South Africa and Tanzania, which amounted to 40% of the world's diamonds by value.

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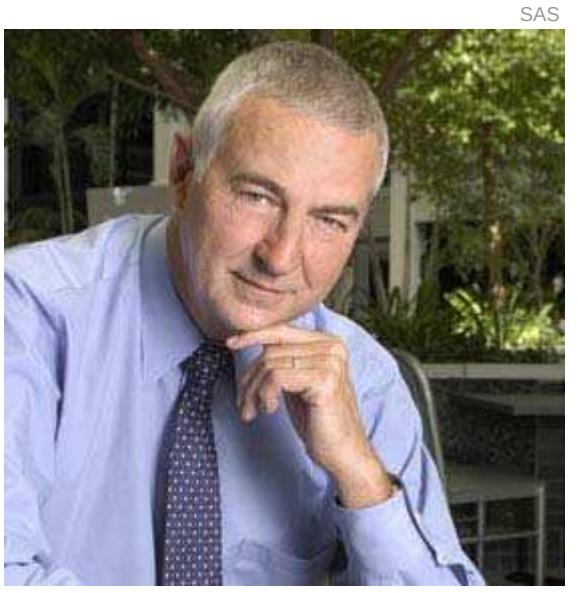
Face value

# Doing well by being rather nice

Nov 29th 2007
From The Economist print edition

SAS



**Jim Goodnight of SAS is reaping the benefits of treating his employees well**

THE ritual of handing out free M&Ms every Wednesday began accidentally, when an assistant collecting supplies accepted a big bag of the chocolate sweets as a substitute from a local grocer who had run short of change. Yet, recalls Jim Goodnight, the co-founder and boss of SAS, probably the world's biggest privately owned software-maker, the M&Ms have come to symbolise the famously employee-friendly culture that he has cultivated at his firm—a culture that seems more valuable with each passing day.

Every aspect of life on the large, leafy SAS campus in Cary, North Carolina, is designed to bring the best out of employees by treating them well. Most SAS employees have their own offices, for example, with the exception of one sales team which wanted to be open-plan, though Mr Goodnight does not expect that experiment to last for long. “You are so much more productive in your own office than when you are being distracted by the people either side,” he says—a belief formed when he worked in an open office on the *Apollo* space project. Offices mean bare walls to fill, so he started to buy art to adorn them; the SAS campus now boasts 5,000 pieces. It also has plenty of outdoor sculpture.

Mr Goodnight co-founded SAS (it rhymes with “lass”) in 1976 on the campus of the University of North Carolina, where he was a faculty member, and where he hated having to pay every time he wanted a cup of coffee. So on the SAS campus, snacks are free and the cafés are subsidised. When Google's human-resources people visited SAS to get ideas for the Googleplex, they found much worth copying—though the internet giant has gone one step further with food, which is free to staff. Mr Goodnight considers that unwise, for tax reasons: “I keep telling Larry and Sergey you shouldn't give away food—the IRS will come in.”

The SAS campus also offers magnificent sports facilities, subsidised child-care and early schooling, and the jewel in the crown, its own primary health-care centre, free to staff. The latter is increasingly being studied by other firms as they struggle to contain the growth of health-care costs (though few firms have the luxury of a large campus on which to build such a facility). SAS estimates that this has reduced its health bills by around $2.5m a year, about one-third of what it would have to pay in the market. It also has a long-term “wellness” programme, supported by two nutritionists and a “lifestyle education” scheme, which is expected to yield further cost savings. Already, the average SAS worker is off sick for only 2.5 days a year.

The only popular employee benefit that SAS does not offer is a stock-option package, usually mandatory in the software industry. That is because it is a privately owned company. It flirted with going public during the dotcom bubble, but decided against the idea—a decision that Mr Goodnight does not regret in the slightest. “We don't have to deal with Sarbanes-Oxley or minority shareholders suing us every time we turn around, or 25-year-old Wall Street analysts telling us how to run our business,” he says enthusiastically. “There are lots of advantages.”

Not surprisingly, employees tend to stick around, which means SAS has to be careful whom it recruits and severe in dealing with mistakes: a philosophy that Mr Goodnight calls “Hire hard, manage open, fire hard.” The tall Southerner may be soft-spoken, but he is no softy. The purpose of treating his employees well is to succeed in business. The average rate of staff turnover at SAS is around 4% a year, compared with around 20% in the software industry as a whole. A few years ago a business-school professor calculated that this alone saved SAS $85m a year in recruitment and training costs.

Mr Goodnight points out that it is not just the benefits that keep people at SAS—“it's the challenge of the work”. SAS is a leader in the field of “business intelligence”, which helps companies use data to understand their own businesses. It has continually increased its annual revenue, to around $1.9 billion in 2006, has always been profitable and has never borrowed a penny. Its success has made Mr Goodnight, now 64, the richest man in North Carolina, with a net worth of around $9 billion. SAS's products are used to perform analysis in data-intensive industries such as insurance, health care, banking and retailing. As other software has become increasingly commoditised, business intelligence has become a hot field. It has attracted the attention of giants such as SAP and IBM, both of which have recently acquired business-intelligence firms. (SAP bought Business Objects for $7 billion, and IBM paid $5 billion for Cognos.)

## Keeping things interesting

SAS has made acquisitions, too, but more cheaply and only to add to its in-house expertise. At the start of this decade Mr Goodnight adopted a strategy of producing “vertical” software to solve particular problems across entire industries, such as banking (fraud detection, money laundering) or retailing (which products to put where, when to restock and with what). His goal is to remain in the more interesting, higher value-added parts of the software business—not least, presumably, to prevent his employees from getting bored.

The philanthropic Mr Goodnight is also interested in working out how to apply computers in education, through the school he has built next to the campus. “This is the most technology-savvy generation of children we have ever had, yet when they go to school, they have to leave this technology behind and watch a teacher at the blackboard,” he says. Not at the Cary Academy, however, where each pupil has a tablet computer. “They love it—it is the way ahead,” says Mr Goodnight, who will no doubt end up adding many of those “savvy” pupils to his workforce. Provided, that is, that the industry's big beasts do not get the better of him. His philosophy of “managing for creativity”, Mr Goodnight reckons, will keep SAS in front. But the real test for his approach will come if the going gets tough.

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Web metrics

# Many ways to skin a cat

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**Such a lot of data, so little information**

IMAGINE you are an advertiser, you want to place your banners on the most popular website, and you want to know how much to pay. Globally, the leading site is Google, which has the most “page views”. Or is it Microsoft, whose various sites have, in the jargon, the most “time spent”? Or should you go by unique users, duration, hits, click-through, impressions, queries, sessions, streams, or engagement? Whether or not there is truth in advertising, there is certainly none for online advertisers, at least none that is immediately obvious and simple. Bob Ivins, who is in charge of all non-American business for comScore, a big web-measurement firm, says that the web produces data as “a fire-hose shoots water”, and that working out what those data mean is rather like “putting a straw into the fire hose to take a sip”. Get the angle even slightly wrong, and you are blown away.

**Page ranks**

Worldwide top ten websites, September 2007

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| 2 | Microsoft sites | Yahoo! sites | Yahoo! sites |
| 3 | Yahoo! sites | Google sites | Microsoft sites |
| 4 | Time Warner network | Time Warner network | Fox Interactive Media* |
| 5 | eBay | Fox Interactive Media* | Facebook |
| 6 | Wikipedia | eBay | eBay |
| 7 | Fox Interactive Media* | Facebook | Time Warner network |
| 8 | Amazon | Tencent | Tencent |
| 9 | Apple | Lycos sites | Lycos sites |
| 10 | CNET networks | SINA Corporation | Baidu.com |

Source: comScore *Includes MySpace

Take, for instance, the case of page views, the most widely used measure for much of the past decade. It is the number of times web surfers call up web pages on a given site. Page views became popular in the late 1990s, because they were far superior to the existing measure of “hits”, also known as “file requests”. Hits are confusing because every graphic on a page, as well as the page itself, counts as a hit. If a site owner puts more graphics on his pages, he gets more hits, even if visitors, clicks and everything else stay the same. “We produced hits numbers because we could, not because it was useful,” says one old-timer in the industry.

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Perhaps advertisers should therefore ditch page views in favour of “user sessions”, since that promises to count actual people, and show how many of them use a site. Except that it doesn't, because this measure counts browsers rather than humans. So 2m sessions could mean, theoretically, that 2m people visited a site once, that 1m people visited twice, or that one astonishing individual visited 2m times. People tend to check their favourite pages in the office, at home, and even from their mobile phones, which leads to an overestimate of the number of users. Conversely, sometimes several people watch YouTube clips when gathered around the same screen, which leads to an underestimate of the number of users. Nobody looking at user sessions would ever know.

As websites, and especially those using AJAX, become more interactive, advertisers are therefore interested in other measures. “Duration” and “time spent”, for instance, suggest how long one or more people were interacting with a page, which in turn hints at how “engaged”, or alert, they were. Using these criteria, social-networking sites such as Facebook and MySpace (part of Fox Interactive Media in the chart) suddenly look attractive.

In the old days of traditional media, measures may have been simpler, but they were also dumber, says Randall Rothenberg, the boss of the Interactive Advertising Bureau, a trade association. In broadcast television or radio, firms such as Nielsen or Arbitron traditionally give gadgets to samples of volunteers that measure what their televisions or radios are tuned to; or they ask people to fill out diaries describing their reading, listening and viewing habits. Both methods produce notoriously unreliable estimates.

The web is an open book compared with those old media. Search advertisements, the text links on the results pages of search engines, charge advertisers only when a user actually clicks, thus expressing an interest. “Pre-roll” advertisements that run at the start of a web video report back exactly how many times they were viewed. But when it comes to banner advertising, says Mr Rothenberg, advertisers just have to consider all these new measures as they would a pointillist painting by George Seurat: looking at one dot is no fun; taking them all in can be rewarding.

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Sovereign-wealth funds

# Dishdashing to the rescue

Nov 29th 2007
From The Economist print edition

**Citigroup calls on sovereign wealth. It joins a long line of supplicants**

CITIGROUP may have lost its bearings and its chief executive, but it has not yet lost its memory. In 1991 a Gulf investor came to the rescue of Citicorp (as it then was), which was strapped for cash as a result of an American property downturn, among other things. Saudi Arabia's Prince Waleed bin Talal, the man in question, largely owes his place on the world's rich-lists to that decision. On November 26th the Abu Dhabi Investment Authority (ADIA), a secretive sovereign-wealth fund, displaced Prince Waleed as the bank's biggest shareholder, paying $7.5 billion for a 4.9% stake.

Citi's shares rallied heartily, but it is not out of the woods yet. The boost to the bank's faltering capital ratio from ADIA's investment will offset expected write-downs on subprime-related investments in the fourth quarter. On the other hand, weakening consumer credit in America and uncertainty over its exposure to off-balance-sheet assets will add to the subprime worries. And ADIA has driven a hard bargain: the fund bought convertible securities that will yield a hefty 11% rate of interest until they become shares in 2010 and 2011.

If Citi falters again, ADIA won't be the only sovereign fund wondering if it may have been too hasty. Recent bets taken by Chinese investors on Blackstone, a private-equity firm, and Barclays, a British bank, have not yet paid off. A Dubai sovereign-wealth fund has seen the value of its stake in Och-Ziff, a hedge fund, tumble since the shares were floated last month. Even Temasek, of Singapore, has had some rare setbacks (see article).

No one likes to lose money, of course, but sovereign investors have deeper pockets and longer horizons than most. For some, it is not all about investment returns. China Development Bank views Barclays as a valuable source of commodities expertise, for example. Stakes in private-equity firms help to shade sovereign investors from scrutiny while offering juicy investment opportunities.

Analysts at Morgan Stanley estimate that sovereign-wealth funds have invested more than $37 billion in financial institutions since April. More deals are likely (UBS, an embattled Swiss bank, seems looks like an obvious target). Chinese financial firms are also buying: Ping An, China's largest insurer, said on November 29th that it had acquired a 4.2% stake in Fortis, Belgium's biggest bank. The political climate may become fairer, too. Even Chuck Schumer, a Democratic senator who rarely passes up the chance to thump tubs, welcomed the Citigroup deal. ADIA's investment may not solve Citigroup's woes but it could help to shift the reputation of sovereign investors from sinister to supportive.

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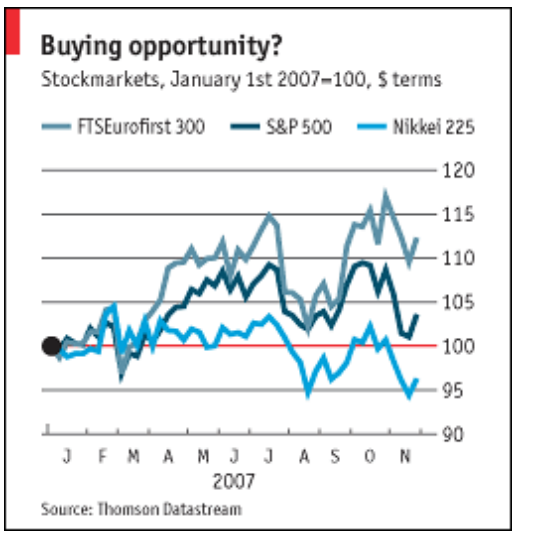
Japan's markets

# Why us?

Nov 29th 2007 | TOKYO
From The Economist print edition

**Though scarcely implicated in the credit crunch, Japan gets it on the chin**

Get article background




ON THE far side of the world from credit-market turmoil, it all seems so unfair. Stockmarkets in America, Europe and Japan all lost their nerve in the summer, but in dollar terms, Japan has fared much worse recently (see chart). In local currency, Tokyo's Nikkei 225 is down by 10.6% since January. Until a sharp rally on November 29th, it was in bear-market territory (defined as a fall of 20% from its high), a distinction it shared only with Sri Lanka, which has a civil war as an excuse.

Why the long faces? After all, the country's direct subprime exposure is tiny. Official estimates put the banks' combined subprime losses for this financial year at ¥600 billion ($5.5 billion), which they can easily cope with. And even a housing-led slowdown in America may not take a heavy toll on the economy. Economists at Deutsche Bank argue that though exports to America slowed this year, Europe and China have more than taken up the slack. If property markets there were to fall, however, Japan would really suffer. On the strength of rising property prices, Chinese and Europeans have splashed out on Japanese cars and the like.

Perhaps the malaise reflects home-grown concerns. Japan's recovery since early 2002, driven by exports and business investment, has been unusually steady, with GDP growth of about 2% a year. Now, though, the economy looks softer and there are only tentative signs of the long-awaited pick-up in consumption.

This is partly because the government is quick to whip out a pile-driver whenever it perceives a policy problem. A clampdown on predatory lending earlier this year has hit consumer spending and created large losses at consumer-finance houses. A new building-standards law, hurriedly passed this summer in response to an earthquake-proofing scandal, has overwhelmed the government inspectors who approve new construction. New building has tumbled by two-fifths compared with a year ago—not even the subprime drama has had that effect yet on America's economy. Lastly, loose talk by the ruling Liberal Democratic Party about doubling the consumption (sales) tax, to 10%, has not helped fragile sentiment, however necessary it may eventually be to pay for Japan's pensions burden.

It is possible to overdo the gloom. Wages are falling partly because a cohort of highly paid baby-boomers is retiring, replaced by younger workers. The recovery is pulling people back into a more flexible labour market. As a result, the total amount households have to spend is inching up. Consumption has improved since August, though not enough to convince the Bank of Japan (BoJ), which has put its planned interest-rate rises on hold.

The stockmarket, down three-fifths from its all-time high in 1989, looks cheap by almost any measure. This week a Dubai investment fund said it had taken a big stake in Sony, Japan's biggest electronics firm. Rumours that China's sovereign-wealth fund was keen on the Tokyo stockmarket provided momentary elation, too.

But the spreading international credit crunch still has the power to deal Japan fresh blows. Foreign hedge funds and the like have been unwinding huge positions in the yen carry trade, where they borrowed cheap yen in order to invest in high-yielding currencies. A rise in the yen—from ¥120 last summer to above ¥108—has all but killed the trade, when measured by open positions in the Chicago futures markets. If the yen climbs much higher, Japanese exporters will squeal. Might the BoJ even be forced to reverse its interest-rate rises? The strangest things appear to happen on Japan's long road to recovery.

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Consumer credit

# Card sharks

Nov 29th 2007 | LONDON AND NEW YORK
From The Economist print edition

**Is the subprime mortgage crisis infecting America's credit-card market?**

WHEN there is blood in the water, it is only natural that dorsal fins swirl around excitedly. Now that America's housing market is ailing, predators have their sights on the country's credit-card market. Analysts at Goldman Sachs reckon that credit-card losses could reach $99 billion if contagion spreads from subprime mortgages to other forms of consumer credit. Signs of strain are clearly visible. There are rises in both the charge-off and delinquency rates, which measure the share of balances that are uncollectable or more than 30 days late respectively. HSBC announced last month that it had taken a $1.4 billion charge in its American consumer-finance business, partly because of weakness among card borrowers.

It is too early to panic, though. Charge-offs and delinquencies are still low. According to Moody's, a rating agency, the third-quarter delinquency rate of 3.89% was almost a full percentage point below the historical average. The deterioration in rates can be partly explained by technical factors. A change in America's personal-bankruptcy laws in 2005 led to an abrupt fall in bankruptcy filings, which in turn account for a big chunk of credit-card losses; the number of filings (and thus charge-off rates) would be rising again, whether or not overall conditions for borrowers were getting worse.

The industry also reports solid payment rates, which show how much of their debt consumers pay off each month. And confidence in credit-card asset-backed securities is pretty firm despite paralysis in other corners of structured finance. Dennis Moroney of TowerGroup, a research firm, predicts that issuance volumes for 2007 will end up being 25% higher than last year.

Direct channels of infection between the subprime-mortgage crisis and the credit-card market certainly exist: consumers are likelier to load up on credit-card debt now that home-equity loans are drying up. But card issuers look at cash flow rather than asset values, so falling house prices do not necessarily trigger a change in borrowers' creditworthiness. They may even work to issuers' advantage. The incentives for consumers to keep paying the mortgage decrease if properties are worth less than the value of the loan; card debt rises higher up the list of repayment priorities as a result.

Card issuers are also able to respond much more swiftly and flexibly to stormier conditions than mortgage lenders are, by changing interest rates or altering credit limits. That should in theory reduce the risk of a rapid repricing of assets. “We are not going to wake up one day and totally revalue the loans,” says Gary Perlin, Capital One's chief financial officer.

If a sudden subprime-style meltdown in the credit-card market is improbable, the risks of a sustained downturn are much more real. If lower house prices and a contraction in credit push America into recession, the industry will undoubtedly face a grimmer future. Keep watching for those dorsal fins.

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Temasek

# Reverse charges

Nov 29th 2007 | SINGAPORE
From The Economist print edition

**The tables turn on Singapore's pioneering investment fund**

TEMASEK'S Singaporean chairman, S. Dhanabalan, rarely gives interviews, so when he issued three golden rules on overseas investments in the *Straits Times* this month, it was worth paying attention. Temasek is one of the earliest and biggest of what are now called sovereign-wealth funds, and is watched closely by its peers. His message was not an uplifting one.

Mr Dhanabalan said that as a result of the impact of rising nationalism on sovereign-wealth investments, Temasek would no longer seek controlling interests in companies outside Singapore, would use local partners and consider the “emotional sentiments” that may be aroused by its acquisitions. All sensible stuff, to be sure. The trouble is, he was speaking after an adverse Indonesian ruling that penalised Temasek even though the company's investments met all three of those criteria.

Antitrust authorities charged Temasek with monopolising Indonesia's telecommunications market, even though it had indirect minority holdings, used a local partner (the Indonesian government) and the stakes were bought at a time—after the Asian financial crises in the late 1990s—when its money was more than welcome.

If an appeal fails, the penalties include fines and a forced sale of its interest in either Indosat or Telkomsel, both prized assets. It follows another embarrassing struggle over a Temasek investment in a Thai telecommunications company purchased from the family of Thaksin Shinawatra, then the prime minister. For Temasek, political risk is on the rise.

To answer what went wrong, it is first necessary to consider what went right. The Indonesian investments were made in 2001 and 2002 through two Singaporean companies in which Temasek was the majority shareholder: SingTel, the old national carrier which is well respected for its management and technology; and a technology conglomerate, STT. Each bought a minority stake in an Indonesian mobile carrier. At the time, the country was still fighting its way out of a financial crisis. No longer. It is now booming, and the two assets are coveted jewels. Share prices in one of them, and those of the listed parent of the other, have quintupled. Indonesia adds 2m new subscribers monthly, but there is still room to grow because of low penetration. To some degree, SingTel has replicated its success by buying stakes in mobile-phone firms throughout Asia.

The case against Temasek was hardly straightforward. Mobile phone calls in Indonesia are getting cheaper. Even though the companies in which Temasek has ties control 80% of the market, they are fighting off more than a half-dozen well capitalised competitors. The original plaintiff in the case against Temasek dropped out. One judge on the five-person adjudication panel wanted the charges dismissed, but he was replaced.

However quirky, this may not be the last such case to bedevil sovereign funds. They like big, privatised assets, such as telecoms firms, and they like them cheap. Such assets, however, are also politically sensitive, as Temasek has learnt to its cost. The lesson is clear: in bad times its money was welcome; in good times, less so. Other funds with an eye on distressed markets in the West should bear that in mind.

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Indian fuel prices

# Too hot to touch

Nov 29th 2007 | DELHI
From The Economist print edition

**The vexing question of subsidies**

AS DUSK falls, kerosene stoves ignite in the poorer kitchens of Delhi. Sengeni, who lives on an alley wedged between the Nizamuddin railway tracks and a tributary known as *ganda nallah* (or dirty ditch), is looking forward to a dish of rice. He is entitled to a quota of 11 litres of cheap kerosene every fortnight, which he buys for about nine rupees (23 cents) a litre, compared with a free-market rate of about 25 rupees. The price hasn't changed for months, he says, despite the surge in oil prices.

In India, as in many countries, the government dares not allow the rising price of crude to be felt in the common man's pockets. Only a third of the 48 developing countries studied in an IMF review let the market set fuel prices. The governments of Yemen and Indonesia, for example, spent more holding down the price of fuel than they spent on health and education combined. Attempts to raise energy prices—as in Yemen in 2005, Nigeria in 2000 or Indonesia in 1998—have a sorry record of prompting riots and revolutions. China's decision to raise prices by 10% in November has also caused tempers to rise.

India's government subsidises kerosene and liquefied petroleum gas (LPG) directly. It keeps other fuels, such as diesel, artificially cheap by the simple expedient of stopping state oil companies from raising their prices. These firms keep themselves afloat with “oil bonds”, which the government guarantees but does not enter on its books. In October, for example, the government announced it would issue bonds worth 235 billion rupees this fiscal year, which will compensate oil-market companies for about 43% of their losses. All told, India's fuel subsidies might cost as much as $17.5 billion this year, according to Lombard Street Research, a British firm of economists. That amounts to as much as 2% of the country's GDP.

Cheap kerosene fires the poor man's stove in India's cities and lights his home in the country's villages. More prosperous city folk cook instead with more refined gases. Thus a kerosene subsidy can at least claim to be progressive as well as expensive. This is more than can be said for India's cheap LPG. According to Bharat Ramaswami of the Indian Statistical Institute, the richer half of India's urban population captures about three-quarters of this subsidy. Unfortunately, about half of India's subsidised kerosene never makes it to household stoves, he says. It is diverted to the black market, where it is either sold at a higher price or used to adulterate diesel, which sells for about 30 rupees per litre.

This then poses an acute dilemma for the government. The subsidies are costly. Yet more expensive kerosene would hurt the poor (not to mention the government's own electoral prospects). And if it kept kerosene cheap while letting diesel rise in price, it would only increase the scope for arbitrage between the two.

Not all fuel in India is subsidised. By the Nizamuddin rail tracks, a gaggle of children warm themselves on a chilly night by burning scraps of wood. One thick-skinned show-off waves his foot in the flames for a foolhardy second. India's fragile government, on the other hand, is in no mood to play with fire.

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Mortgage restructuring

# Group therapy

Nov 29th 2007 | NEW YORK
From The Economist print edition

**As defaults soar, America seeks to modify mortgages en masse**

THE statistics are chilling. As many as 2m adjustable-rate subprime mortgages, worth $350 billion, are due to reset to higher interest rates in America over the next 18 months. Resets on Alt-A (or near-prime) loans will continue to climb until late 2010. House prices are tumbling (see article). What can be done to avoid a bloodbath of defaults?

Enter the Gubernator. Galvanised by the fact that a quarter of all resets will come in his state, Arnold Schwarzenegger, California's governor, has struck an innovative deal with four big loan servicers. This will see the companies extend by several years the period for which thousands of borrowers can stay at the initial “teaser” rate. Crucially, the four have agreed to “fast-track” their procedures to make it easier to include whole swathes of struggling but not hopeless borrowers.

Washington is throwing its weight behind this kind of mass loan modification. Bank supervisors have urged servicers—who collect mortgage payments and pass them on to investors—to work out new deals with borrowers. The Federal Reserve's Randall Kroszner has encouraged the industry to explore efforts to help large groups of borrowers. Henry Paulson, the treasury secretary, has come round to the same view after concluding that servicers lack the resources to deal with case-by-case modifications. “We are going through uncharted territory,” he says.

The boldest suggestion has come from Sheila Bair, chairman of the Federal Deposit Insurance Corporation, a guarantor and supervisor. The crisis is so grave, she argues, that most borrowers who are facing resets but still paying their dues should be given the chance by servicers to switch into fixed-rate loans at the starter rate for the full 30 years.

Some are hoping that the Californian experiment, which builds on Ms Bair's proposal, will provide a template for a nationwide scheme—if the economics work. They may well. Foreclosure is expensive, typically eating up 20-25% of the loan balance, says Joseph Mason of Drexel University. Modification means smaller cash flows but also fewer defaults. Handling each case separately can be costly, too. Loan servicing is about transaction-processing, not customer service, points out Guy Cecala of *Inside Mortgage Finance*, a newsletter. Analysing borrowers case by case requires beefing up work-out departments. Mass modification is less labour-intensive and thus, for an industry with wafer-thin margins, more appealing.

In September Moody's, a credit-rating agency, estimated that the case-by-case approach had barely made a dent in the problem, with only 1% of adjustable-rate subprime loans recast. But it will take time for firms to sort the loans in their portfolios into different risk buckets as a first step towards modifying them en masse, says Bill Rinehart of Ocwen, a servicer in Florida.

The trick is to root out both the basket-cases and also those who don't need help. The best way to achieve this, reckons Mr Paulson, is through an industry-wide approach that sets out “relatively few, simple criteria” on who deserves a break.

Hence the strong Treasury backing for Hope Now, a wide-ranging alliance of consumer groups, servicers and investor groups, including the American Securitisation Forum (ASF). It has two main goals. The first is to reach borrowers who elude servicers acting on their own. Up to half of those struggling to pay ignore calls and letters, assuming that the reason for contact is to foreclose rather than negotiate.

More importantly, the alliance is working on principles governing who qualifies for loan alteration. Mr Paulson expects these to be unveiled before the end of the year. Unlike the Californian plan, they will extend to the one-third of subprime borrowers who took out fixed-rate mortgages. That will please those who see no reason why help should be offered only to those who took out unconventional loans.

Perhaps the biggest task will be to steer through complex securitisations. The ASF has moved swiftly to reinterpret the labyrinthine “pooling and servicing agreements” that govern the process in a way that makes systematic modification easier, says Steve Bailey of Countrywide, America's largest mortgage lender.

But whereas investors agree that in most cases everyone is better off if a loan is recast rather than falling into delinquency, they argue that standardisation should go no further than counselling techniques and databases. Technical issues still need to be ironed out, too. The Internal Revenue Service, for instance, has yet to issue guidance on the tax treatment of mass modification. And servicers worry about possible lawsuits from investors. They also fret about costs. Expenses they incur from foreclosures are reimbursed by the securitisation trust, whereas those from modifications are not. (The Office of Thrift Supervision, a regulator, has proposed a payment of $500 to servicers for each loan they modify.) Nor is it clear that the overall costs of modification are always lower than those of foreclosure. In a recent paper*, Mr Mason points out that modified loans experience a 35-40% re-default rate over the following two years—though the data were thin and preliminary.

Tony Sanders of Arizona State University points to another worry. If Alt-A defaults are indeed the next credit meltdown, then extending teaser rates might simply postpone the pain for a few years. “We do not know enough about subprime and Alt-A default tendencies to undertake such a monumental and potentially unfair reallocation of payments,” he says.

Claims of unfairness are likely to crop up a lot in coming months. The one certainty about mass modification is that it will benefit some who do not need help and others for whom assistance is just a postponement of the inevitable. However, more and more market-watchers think that is a price worth paying if it helps avert an avalanche of defaults.

*“Mortgage Loan Modification: Promises and Pitfalls”, October 2007.

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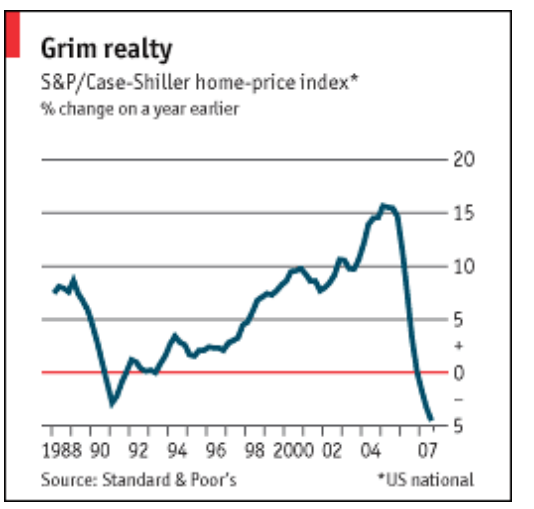
American house prices

# Fantasy or phobia?

Nov 29th 2007 | PORTLAND
From The Economist print edition

**It's no fun playing any more on the property ladder**

AS MANY as 18m American adults play fantasy sports leagues. Movie buffs play Fantasy Mogul and anyone who thinks politics is not already surreal enough can play Fantasy Congress. The latest online game is "fantasy real estate", run by Realius.com, which emerged in November in San Francisco and enables players to guess the price of properties on the market in the Bay area. It may sound like the daftest moment to introduce a game using the wisdom of crowds to judge the value of a home—especially when for so long popular wisdom in America has been that house prices do not fall. On the other hand, rarely have American homeowners been so in need of escapism.




More evidence emerged this week of just how bleak the real world has become for homeowners—and not just those saddled with subprime and adjustable-rate mortgages. On November 27th the S&P/Case-Shiller National Home Price Index reported a fall in American house prices of 4.5% in the third quarter compared with a year earlier, the biggest drop recorded in its 20-year history. Robert Shiller, the Yale University economist who helped design the index, does not provide a forecast for next year, though he says that futures prices on the S&P/Case-Shiller Composite traded in Chicago anticipate that they will fall a further 5%. On the other hand, declines of 50% are not "out of the question", he says.

For most homeowners, that would be a nightmare. But Professor Shiller provided possible solace. During the last slump in 1991, the home-price index did a quick about-turn and soared higher (see chart). The latest data contained signs (albeit inconclusive ones) of a slight slowdown in the rate of decline.

Other data give few grounds for optimism, though. On November 28th the National Association of Realtors announced a 1.2% drop in sales of American homes traded from one buyer to another in October. The annual rate of 4.97m homes was the lowest since it first began measuring in 1999.

Perhaps there is a more down-to-earth recommendation than fantasy real estate for anyone wanting to play the market without buying or selling a home. As Professor Shiller says, use the futures markets to hedge against a crash.

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Economics focus

# A less fiery dragon?

Nov 29th 2007
From The Economist print edition

**China may be a smaller economic giant than previously thought**

Get article background

AMERICANS who spend their time fretting about when their economy will be overtaken by China will have gleefully leapt upon new numbers suggesting that China's economy may in fact be 40% smaller than current estimates. However, the new figures, if confirmed, would also mean that the world economy has been growing rather more slowly in recent years than officially reported by the IMF, which is less salutary for everyone.

It is not the Chinese government that has been exaggerating the size of its GDP, but international organisations, such as the World Bank and the IMF, which measure each nation's output in terms of purchasing-power parity (PPP). If China's GDP is converted into dollars using market exchange rates it amounted to $2.7 trillion last year, only one-fifth of America's $13.2 trillion, and the fourth-largest in the world. But a dollar buys a lot more in China than in America because prices of many non-traded goods and services tend to be much lower in poor economies. Converting a poor country's GDP into dollars at market exchange rates therefore understates the true size of its economy.

Instead many economists prefer to convert GDPs into dollars using PPPs, which take account of price differences between countries. *The Economist*'s Big Mac index is a crude measure of PPP. Much more sophisticated estimates are produced by the International Comparison Programme, co-ordinated by the World Bank, which gathers prices for more than 800 goods and services in countries around the globe. On a PPP basis, the World Bank ranks China as the world's second-biggest economy, with a GDP of $10 trillion last year. At its recent pace of growth, China's GDP could overtake America's by 2010.

The World Bank's estimate for China is widely used by economists. Yet few realise that it is based on a lot of guesswork, as the bank's previous international price surveys have not included China. Instead, it extrapolated from a study of prices in America and China that dates all the way back to the 1980s. The bank's latest price-comparison study, due to be published in mid-December, does include China for the first time, and preliminary evidence indicates that its GDP has been overstated in the past. In a recent article in the *Financial Times,* Albert Keidel, an economist at the Carnegie Endowment for International Peace, noted that PPP figures published by the Asian Development Bank (ADB), as part of its input into the World Bank's International Comparison Programme, implied that China's GDP was 40% smaller than the number reported by the World Bank. Interestingly, the new figure is very close to what the Big Mac index has indicated all along.

Mr Keidel's claim is itself based on some guesswork. The ADB report does not actually reveal the yuan's revised PPP rate against the dollar, as it only compares prices with those in Hong Kong, not America. To derive dollar PPPs Mr Keidel has assumed that relative prices in Hong Kong and America have not changed since previous studies. If this holds, then China's implied GDP is indeed 40% smaller than before. The World Bank says that it is still discussing the final numbers. Note, however, that the ADB figures imply that India's GDP is also now 40% smaller, even though India has taken part in previous international pricing surveys (suggesting that Hong Kong's PPP may in fact have changed). It is thus possible that China's GDP may be trimmed by less than 40% when the World Bank publishes its final report.

Assume for a moment that Mr Keidel's figure of 40% is correct, then China's GDP in PPP terms is slashed from $10 trillion to $6 trillion. That would still leave it as the world's second-largest economy, but it would not overtake America for at least another ten years. India, on the other hand, would drop from third to fifth place in the world ranking.

## Adjusting the global speedometer

China would probably be quite happy to see its GDP revised down, hoping that America might stop picking on a smaller, poorer economy. But revised PPPs would not only change international rankings, they would also affect the pace of global growth. To calculate world GDP growth, individual countries' growth rates are weighted by their share of world output. Using PPP weights, as the IMF does, the world economy has grown by an average of 5% over the past five years, its strongest pace since the early 1970s. This is largely because emerging economies have been growing by 7.5% a year (compared with only 2.3% in the G7 developed economies), and they account for around half of world GDP. But if China and India are 40% smaller than previously thought, world growth would be trimmed to 4.5%.

The difficulty of measuring PPP is one reason why some economists prefer to compare the sizes of economies using market exchange rates. After all, it is argued, countries trade with each other at market rates, so these provide the best basis for comparison. Measured this way, world growth over the past five years has been a still more modest 3.4%. Far from being the fastest pace for decades, that is slower than in the 1980s (see left-hand chart). So has the global boom been a mirage? A closer look at the numbers shows that this cannot be right. Measured at market exchange rates, emerging economies' share of global output last year was less than in 1980 (see right-hand chart), even though they have been growing more than twice as fast as the rich economies. The increase in their share of global energy consumption, from 43% in 1980 to 55% in 2006, also confirms that their weight in the world economy has surely risen.

The raw dollar numbers are distorted by big currency swings. For instance, the devaluations in East Asian economies in 1997-98 grossly exaggerated the drop in their output. Measured at PPP, emerging economies' share of world output has more realistically risen since 1980—and even if China's economy is smaller than thought, it is still a mighty beast. PPP data may be imperfect, but they give a better picture of the relative size of economies than market exchange rates do. In the words of John Maynard Keynes, “It is better to be roughly right than precisely wrong.”

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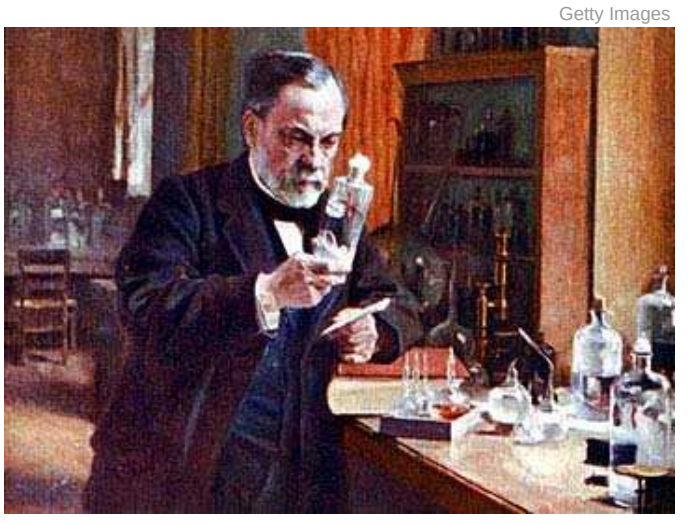
Genetics and infectious disease

# The germ of an idea

Nov 29th 2007 | PARIS
From The Economist print edition

Getty Images



**Some people are more prone to infection than others. One answer could be to dose them with the molecules that their immune systems cannot make**

LOUIS PASTEUR, the 19th-century French microbiologist and chemist, is credited with confirming that microbes cause disease. When studying ailing silkworms, he made two vital observations. The first was that *la flacherie*, as the worms' illness was called, was contagious. This led to the germ theory of disease and, ultimately, to the development of antibiotics to treat infectious illnesses in people. In all the excitement over germs, however, his second observation got overlooked: *la flacherie* was passed from parent to offspring. Almost 150 years later, the idea that susceptibility to infectious disease can be inherited is finally coming of age. A meeting held last week at the Pasteur Institute in Paris heard how the next generation of drugs will target not the microbial agents of infectious illness but their human hosts.

To this end, researchers are studying how different versions of certain genes could cause some people to succumb to infection whereas others are left relatively unscathed. They thus hope to explain not only why some people can be infested with virulent microbes without contracting a disease (whereas others become ill even though they are less infected) but also why such patterns run in families and in ethnic groups.

Laurent Abel and Jean-Laurent Casanova of the Necker Medical School in Paris have found that a different version of a single gene out of the 25,000 or so in the human genome can make all the difference to whether or not a person suffers from many common diseases.

## Nature not nurture

The *Herpes simplex* virus, for example, infects 80% of adults. The worst symptom in most of them is a cold sore but, in a few unlucky children, the virus causes a serious inflammation of the brain called *H. simplex* encephalitis (HSE), which can lead to brain damage resulting in epilepsy, mental retardation and even death. Dr Casanova has identified two genetic mutations in children who have survived HSE that result in the same deficiency—the lack of a molecule called type 1 interferon that plays a role in innate immunity.

Innate immunity is the defence against infection that babies are born with, as opposed to adaptive immunity which is acquired as people develop antibodies through their exposure to disease-causing agents. Whereas adaptive immunity is thought to be a response to specific bacteria, viruses, fungi and parasites, innate immunity has always been seen as the body's general response to all threats of disease. The children who survived HSE, however, were resistant to plenty of disease-causing agents other than the *H. simplex* virus, suggesting that innate immunity could be specific, too.

Dr Casanova thinks HSE is the first example of a disease that was thought to be purely infectious but which has turned out to be purely monogenic—that is, under the control of a single gene. He has found a half-dozen other diseases that behave similarly. Dr Abel, meanwhile, is trying to gauge how common these genetic effects are. Based on a study of nearly 200 Vietnamese families affected by another infectious illness, the bacterial disease leprosy, he and his colleagues have identified a single gene as a strong risk factor for leprosy in children under 16 years old.

The pair suspect that everyone will turn out to have narrow chinks in their immune armour that leave them vulnerable to certain infections, and that most life-threatening infectious diseases that strike before puberty will be monogenic—although they are far from proving this. Others believe that the genetic control of susceptibility to infectious disease forms a spectrum, of which Dr Abel and Dr Casanova have only seen one extreme. At one end are diseases that are controlled by one or a few genes; at the other, diseases to which many genes contribute in small, cumulative ways.

Somewhere in the middle may be schistosomiasis, a debilitating disease caused by a parasitic flatworm carried by water snails, which affects 200m people worldwide. The worm causes liver damage that the body's natural mechanisms must repair. Those who are most susceptible to the disease have over-zealous repair mechanisms that replace too much liver with useless scar tissue.

Alain Dessein, of INSERM, a French medical research agency, who is based at the University of the Mediterranean in Marseille, has found that 70% of the susceptibility to schistosomiasis is under the control of one or two genes that regulate liver repair. He hopes that a pharmaceutical firm will now devise tests based on these genes to identify those in whom scarring progresses rapidly or slowly, as well as drugs that improve healing.

Malaria, which kills more than 1m people a year and contributes to the deaths of a further 1.7m, according to the World Health Organisation, probably falls at the multigenic end of the spectrum. In the 1950s Anthony Allison, a British biochemist, observed that Africans who carry a single copy of the genetic mutation that causes sickle-cell anaemia are protected against malaria. It is now known that genetic variability accounts for 25% of susceptibility to the disease, but that variations in the sickle-cell gene contribute to only a fraction of that. Other genes must therefore be involved.

## Malarial mice

At McGill University in Montreal, Canada, Philippe Gros and his colleagues are looking for those genes in mice, by comparing the susceptibility of different types of mouse to one stage of the disease. Malaria is caused by parasites that are transmitted by mosquitoes. Once inside the body, the parasites multiply first within the liver and later within red blood cells. Dr Gros and his colleagues are examining the second part of this process because it is after this stage that infected blood cells can become trapped in small blood vessels in the brain, causing cerebral malaria and, potentially, death. They have found that, at least in mice, an enzyme called pantetheinase confers resistance to the multiplying of the malarial parasite within red blood cells.

It turns out that pantetheinase is needed for the synthesis of a small molecule called cysteamine and, by treating pantetheinase-deficient mice with cysteamine, Dr Gros claims to cure them of malaria. It remains to be seen whether cysteamine will have the same effect in people, but Dr Gros is planning clinical trials in which malaria patients will be treated with the molecule in combination with standard anti-malarial drugs.

The same principle—of replacing an immune molecule the body lacks, to increase its resistance to infection—underlies a treatment Dr Casanova is hoping to develop for HSE. On diagnosis with the condition, young patients who are found to have a type 1 interferon deficiency will be given both a standard anti-viral drug and the interferon they lack. Such a combined treatment could improve the chances for children who may otherwise die or suffer brain damage. Perhaps Pasteur's second observation will eventually have as great an impact on humanity as his first.

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Drug-resistant infections

# Riding piggyback

Nov 29th 2007
From The Economist print edition

**Farm animals are infecting people with a new strain of superbug**

FILTHY surroundings that are home to a population fed on antibiotics provide the ideal breeding grounds for superbugs. But badly run hospitals are not the only such places. Farms where animals are reared intensively also provide an incubator for drug-resistant diseases. Recent research suggests that veterinary surgeons and farmers in Europe and Canada may be picking up potentially fatal infections from pigs and possibly cattle.

Superbugs evolve when common bacterial infections develop resistance to the drugs used to treat them. The most widespread cause of hospital infections, methicillin-resistant *Staphylococcus aureus*, or MRSA, is one such example. About a third of people carry some form of *S. aureus* on their skin, where the bacteria do no harm. However, if they enter the bloodstream, they can cause disease. And if the resulting illness cannot be treated because the bacteria are drug-resistant, the infection can prove fatal. MRSA killed some 19,000 people in America and 1,600 people in Britain in 2005, the latest year for which figures are available.

In the Netherlands such outbreaks are relatively rare. Yet a new strain called non-typable MRSA, or NT-MRSA, has recently emerged there. The strain first appeared in 2002 and now accounts for more than 20% of human infections. Unlike most other strains found in people, NT-MRSA strongly withstands a group of drugs called tetracyclines, which are antibiotics that are heavily used in livestock. It seems highly likely that the medication of farm animals led to the evolution of the strain that has since been passed to people. Indeed, last year Albert de Neeling and Xander Huijsdens of the Dutch National Institute for Public Health and the Environment, in Bilthoven, found NT-MRSA in 39% of pigs and at 81% of pig farms.

Now Dr Huijsdens and Inge van Loo of the St Elisabeth Hospital in Tilburg have found further evidence to support this theory. They compared 35 people with NT-MRSA with 76 people carrying other strains of the superbug. Those who carried NT-MRSA were 12 times more likely to have come into contact with pigs and 20 times more likely to have come into contact with cattle. The pair plotted the infections on a map, and found that the distribution of NT-MRSA cases coincided with the locations of pig and cattle farms. The results will be published in a future issue of *Emerging Infectious Diseases*.

So far, it is not clear whether the strain is spreading beyond farms to cause infections elsewhere in the population. But Dr van Loo has detected MRSA, including the new strain, in meat samples from Dutch supermarkets and butchers. The bacteria were present only at low levels that are unlikely to cause disease if food is properly cooked. Certainly, no one is yet known to have caught NT-MRSA from eating infected meat. Yet keeping the bacteria out of the food chain would be a sensible idea. At least one outbreak of a different strain of MRSA has been traced to the eating of contaminated food by a hospital patient with a weakened immune system.

Because the pigs are exported, the problem is spreading to other countries. NT-MRSA has already been detected in Denmark, France and Singapore. In a paper to be published in *Veterinary Microbiology*, Scott Weese from the University of Guelph in Ontario, Canada, found the strain in 25% of local pigs and, more worryingly, in 20% of pig farmers. Human cases of NT-MRSA are extremely rare in Canada but could become more common if the infection spreads among the pig population.

Moreover, the United States is the biggest importer of Canadian bacon, ham and pork. It is already experiencing a large increase in the number of infections caused by new strains of MRSA that are emerging from places other than hospitals and nursing homes. Such infections appear to be more virulent and more easily spread between people than earlier strains. They have even afflicted the fit and the young—who were not previously thought to be susceptible to superbugs and the diseases they cause.

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Planetary science

# Barren land

Nov 29th 2007
From The Economist print edition

## Why Venus is lifeless

FOR a planet named after the goddess of love, Venus is something of a misfit. Its clouds of sulphuric acid, crushing atmosphere of carbon dioxide and blast-furnace surface temperature of 457°C are anything but lovely. Yet in its youth it was, like its gentler sister Earth, swathed in oceans that provided a suitable breeding ground for life. What went wrong?

Since 1962 more than 30 spacecraft have made the trip to Venus, seeking to understand Earth's nearest neighbour and so-called twin planet. The most recent of these, *Venus Express*, was launched by the European Space Agency in 2005. In the current issue of *Nature*, nine papers report what it has found so far.

Hakan Svedhem, of the European Space Agency, and his colleagues say that Earth and Venus probably started out much the same. The Earth's oceans teemed with plants and animals that converted most of its atmospheric carbon dioxide into carbonates and sank to the bottom as they died, to become sedimentary rocks. By contrast, Venus lost most of its liquid water. That is because Venus, being closer to the sun, started to warm up. This generated more water vapour in its atmosphere, further increasing the temperature in a runaway greenhouse effect.

Planetary scientists have also long blamed Venus's sterility on the lack of an internal magnetic field. The sun zaps its planetary neighbours with the “solar wind”, a stream of highly energetic charged particles. Damaging cosmic rays also bombard the planets. The Earth is protected from much of this radiation because it has an internal magnetic field that generates a protective magnetosphere. But Venus has no such protection, possibly because it does not rotate much.

Yet according to Tielong Zhang, of the Space Research Institute at the Austrian Academy of Sciences, and his colleagues, Venus does still manage to avoid much of the bombardment. Dr Zhang says that the solar wind itself carries a magnetic field all the way to Venus where it encounters the planet's electrically charged upper atmosphere, or ionosphere. Venus's ionosphere is highly conductive, and data taken by *Venus Express* suggest that the solar wind cannot penetrate it at any time. Like a boat trying to cut through the ocean waves, the induced magnetic fields pile up where the solar wind meets Venus's ionosphere. The solar wind fluctuates in strength, but is prevented from entering both when it is strong and when it is weak.

On the dark side of the planet things are much quieter. Shielded from the buffeting of the solar wind, ions quietly leak out of the atmosphere. *Venus Express* has detected oxygen, hydrogen and helium ions—remnants of early oceans—escaping into space. The two sisters may have started as twins but, as they have grown older, they have grown apart.

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Vision and nutrition

# A bird's eye view

Nov 29th 2007
From The Economist print edition

**Some creatures know how to identify and choose healthy food**

ANTIOXIDANTS are the health freak's weapon of choice. They mop up molecules in the body that would otherwise damage cells and could cause cancer. They are found in many fruits and vegetables, and even in red wine. Without biochemistry, people would not know of their existence. But researchers now think that birds can see them and that they choose foods containing them.

In the wild, plants need to disperse their seeds to survive and colonise new areas. One way of doing this is to grow attractive fruits that animals eat, pips and all. The creatures then spread the seeds as nature takes its course. That is why plants produce fruit that is often brightly coloured and tasty. But do animals also choose to eat fruit because it is nutritious?

Alamy

**In the pink**

To find out, Martin Schaefer of the University of Freiburg, in Germany, and his colleagues set out to see whether creatures can sense antioxidants. They analysed how 60 different fruits appear to the birds that disperse their seeds. Birds see colours in their own way, because they are sensitive to wavelengths, such as ultra-violet, that are invisible to people. The researchers found that birds could clearly perceive the strong ultra-violet coloration given to the fruit by the presence of a group of antioxidants called anthocyanins.

That does not necessarily mean that birds would chose anthocyanin-filled fruit. So Dr Schaefer conducted an experiment using 11 captive female blackcaps. For four days, the birds were given a choice between two cups of food that were identical except that the food in one was blue in colour because it contained anthocyanins. All the birds chose the food with the anthocyanins, which confirmed both that the birds could see the compound and had a preference for it. This suggests that, in evolutionary terms, having antioxidants present in fruit would make a plant more successful at attracting seed dispersers.

It also means that the birds may be able to medicate themselves. Dr Schaefer is now examining their choice of diet at stressful times, such as during migration. He wonders whether birds suffering oxidative stress increase their antioxidant consumption by choosing fruits with high anthocyanin content—rather like starting the day with a glass of orange juice when you feel a cold coming on.

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**Thabo Mbeki**

# Mystery man

Nov 29th 2007
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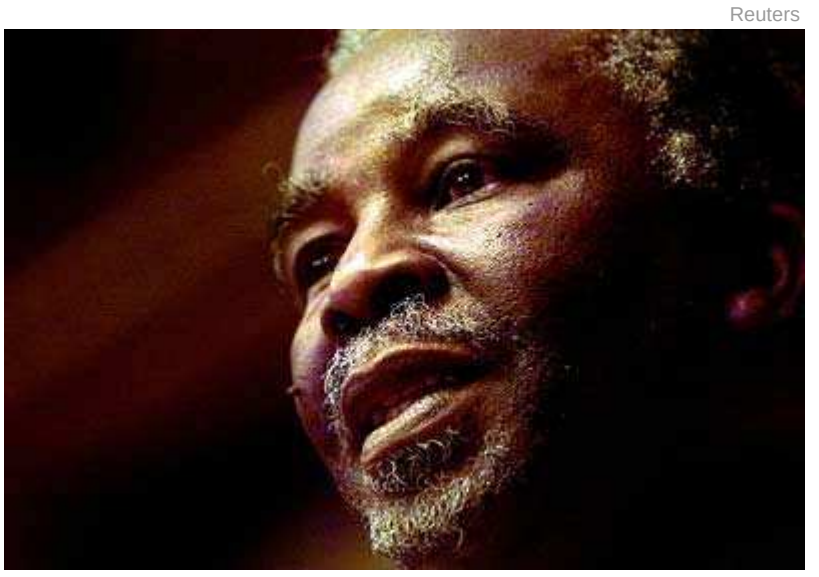
Reuters



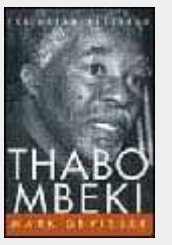
**A profound sense of disconnection is the key to understanding South Africa's enigmatic and controversial president, as a long-awaited biography makes clear**

AS THE African National Congress (ANC) prepares later this month to elect the man who will lead it for the next five years, there is more interest than ever in Thabo Mbeki. Barred from running in 2009 for a third term as South Africa's president, Mr Mbeki, who is also the current head of the ANC, is one of the front-runners for re-election to the top party job.

However, after 13 years in power—first as Nelson Mandela's deputy before succeeding him in 1999—the president has come to be respected or loathed, but hardly ever loved. Even among his closest followers, Mr Mbeki remains an enigma. Some consider him to be a cool-headed and visionary moderniser, others a scheming centraliser who will not tolerate dissent.

Mark Gevisser, a South African journalist, has spent eight years working on his biography of the president, which so far is published only in his home country. He has studied hundreds of documents and interviewed more than 200 people, including, at length, Mr Mbeki himself. Mr Gevisser's book retraces in great detail the president's life from his childhood in rural Transkei to his 28 years in exile and his ascent to power. In the process he sheds considerable light on more than half a century of South Africa's difficult history.

Thabo Mbeki: The Dream Deferred
By Mark Gevisser




*Jonathan Ball Publishers; 892 pages; 225 rand*

The book's title comes from a poem by Langston Hughes, a black American poet, that Mr Mbeki often cites. The “dream deferred” is not only that of a nation which is still struggling to close the gaps between black and white, and rich and poor, but, as the author asserts, also Mr Mbeki's own. One of the book's most important themes is how disconnected Mr Mbeki appears to be from his roots and his country, and how this has influenced his opinions and behaviour.

Mr Mbeki's father was an anti-apartheid hero. Both he and Mr Mbeki's mother were also communists. Both came from families of educated black landowners. Despite that, Mr Mbeki's family history is one of destitution, as apartheid systematically destroyed black hopes and opportunities. It is also one of loss: Mr Mbeki's only son, fathered when he was still a teenager, disappeared without trace in the early 1980s, as did his younger brother. Mr Mbeki followed in the steps of his distant father by sublimating his emotions into the anti-apartheid struggle, which became his life. He found a surrogate family in the party and a spiritual father in Oliver Tambo, who led the ANC in exile.

According to Mr Gevisser, Mr Mbeki's vision of an African renaissance is an attempt to overcome the damage done by this sense of disconnection and to resurrect his continent's feeling of pride and identity. His yearning for a specifically African approach to the continent's problems is the reason why he continues to question so strongly the supposedly “Western” view that HIV causes AIDS, and hence opposes proper treatment of the disease. Astonishingly, Mr Gevisser reports that Mr Mbeki has not changed his weird and destructive views on HIV/AIDS. Furthermore, he even regrets having kept silent on the subject over the past few years.

Another constant is Mr Mbeki's obsession with conspiracy—against him personally or against Africa at large. Plotters include ruthless pharmaceutical companies, political rivals, an unfair world order, the media, or the white business sector—which he often describes as being full of “counter-revolutionaries” and racists.

What happened, then, to the man once described as “the ANC's Crown Prince Charming”, the moderate voice of reason that reassured business and even some white hardliners in the 1980s and early 1990s? The author argues that Mr Mbeki used his charm strategically. Once in power, he preferred to focus on his quest for Africanness. He was also keen finally to come out of the shadow of his elders. “He knew that because people would never love him the way they did Madiba [Mr Mandela], they would need to respect him, even if it meant fearing him.”

According to Mr Gevisser, the extreme prickliness Mr Mbeki commonly shows when faced with criticism is also the result of the terrible frustration he feels at being unable fully to deliver on the impossible expectations of his fellow South Africans. “Liberation movements are driven by dreams, and the ANC has been no exception,” the author writes. “But its history in government has been a perpetual scaling back of these dreams.”

Uncharismatic and unable to charm a crowd, he is instead an expert navigator of the corridors of power. Mbeki's understanding of power is that “it is both gained and conceded through conspiracy,” Mr Gevisser writes. He “might have modernised the ANC with extraordinary vigour when it came to ideology and economic policy, but he would hold to the exile's understanding of politics—and the outlawed freedom fighter's experience of intrigue—throughout his years of power.”

Mr Gevisser tries hard to be fair. It would have been interesting to hear more of his personal views, yet he does not voice any conclusive judgment about the president, wanting instead to “stand on his subject's shoulders” to see the world through his perspective. Nevertheless, his book explains much about the very private Mr Mbeki. That alone makes it essential reading for anyone intrigued by South Africa's complex philosopher-king.

Thabo Mbeki: The Dream Deferred.
By Mark Gevisser.
*Jonathan Ball Publishers; 892 pages; 225 rand*

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German politics

# Local hero

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From The Economist print edition

“EXCUSE me, Mr President, but you are an asshole.” That is how Joschka Fischer, a pioneer member of parliament for the Green Party, responded to a threat of ejection from the Bundestag, Germany's lower house, in a heated debate in 1984. Mr Fischer was duly made to leave the chamber. But the *enfant terrible* of German politics, who had been a revolutionary in 1968, was able to shrug off his early hotheadedness and eventually take his place as foreign minister in Gerhard Schröder's Social-Democrat/Green coalition from 1998 to 2005. German politics has been a duller place since Mr Fischer left to teach and write.

His beginnings were inauspicious: school drop-out, shoplifter, occasional taxi-driver. But his appetite for ideas drew him to the fringes of university life, in Stuttgart then Frankfurt. Student protesters were on the march in Europe then, particularly in Germany, where the post-war generation was becoming increasingly exasperated by its elders' silence about the Nazi era. Revolution was needed. Some took it too far with acts of terrorism, but Mr Fischer did not. His intervention, in 1976, in a notable address in Frankfurt's town square, probably saved the German peace movement from its sympathies with the Baader-Meinhof gang.

Reuters

**Red and green in tooth and claw**

Paul Hockenos, an American political analyst based in Berlin, argues consistently well that the Greens helped to break the complacency accompanying Germany's post-war economic miracle. Daniel Cohn-Bendit, Petra Kelly and Mr Fischer are the names most closely associated with the early Green movement, but it was Mr Fischer, with the pragmatism of the *realo* Greens, rather than the idealism of the *fundi* Greens, who took the party into responsible national government.

At times it nearly died. In 1990 Green opposition to re-unification badly misread the mood of the nation: in the first general election after re-unification it lost all its seats in what used to be West Germany. But within four years the Greens were back, with 7.3% of the vote and a following among the prosperous as well as the left.

However it was only after 1996, when Mr Fischer was left by his third wife and decided to lose weight, that the “Joschka effect” began really to take hold. In the 1998 election campaign the (by then) slim-line Mr Fischer travelled the country tirelessly in a green “Joschka bus” whipping up support. The Greens did so well compared with the SPD that they earned three key portfolios in Mr Schröder's cabinet—foreign affairs, the environment and health.

Within weeks Mr Fischer was fighting for the coalition's future and his own position as party leader. This is where his new book, “Die rot-grünen Jahre” (The red-green years), kicks in. NATO wanted Germany to join a proposed military strike on Serbia, which was reportedly backing genocide in Kosovo. It would be the first military action by German troops on foreign soil since 1945—anathema to Germans brought up on the mantra “never again war”. With a rousing speech at a party congress, and despite a direct hit by a bag of red paint, Mr Fischer took his party and his country to war.

Mr Fischer recounts his experiences as foreign minister, the special relationship that he developed with Madeleine Albright, his American counterpart, and to some extent with Colin Powell, her successor, despite differences on Iraq. But he knew at once, for example, that he would never get on with Dick Cheney, the American vice-president.

Mr Fischer is most interesting when he recounts the human moments—squeaking with exasperation as he watched Bayern Munich lose to Manchester United in the 91st minute while he was on the phone to Ms Albright. Or when, despite the political incorrectness, he shook hands with a former German terrorist in court, because they had once been mates. He also candidly admits that he would have preferred Oskar Lafontaine, a mercurial leftist, to Mr Schröder as chancellor, and that he disliked many of his federal party colleagues. Mr Fischer's next book, which will cover the time after September 11th 2001, may have more shape to it, since it will include the Iraq war and his exit from politics. But it would be useful for the Anglophone layman to read Mr Hockenos's book first.

When Germany was asked in 2002 to join the “coalition of the willing” against Iraq, the government refused. The cynical view is that Messrs Schröder and Fischer faced probable defeat in the forthcoming election and had nothing to gain by joining in an unpopular war. But Mr Hockenos gives Mr Fischer credit for his toughness when challenged by Donald Rumsfeld, the American secretary of defence. “You have to make your case,” Mr Fischer insisted: “Sorry, you haven't convinced me.”

Mr Hockenos is not always so kind. Mr Fischer as foreign minister could be “rude and overbearing” to his staff. But overall his book is an enlightening yarn about a local boy made good, who several times, by the skin of his teeth, saved his party, his government and his reputation.

Joschka Fischer and the Making of the Berlin Republic: An Alternative History of Postwar Germany.
By Paul Hockenos.
*Oxford University Press; 400 pages; $35. To be published in Britain by OUP in February*

Die rot-grünen Jahre: Deutsche Aussenpolitik—vom Kosovo bis zum 11. September.
By Joschka Fischer.
*Kiepenheuer & Witsch; 444 pages; euro22.90*

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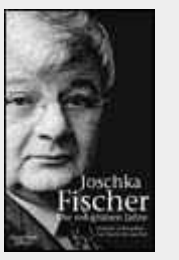


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American poetry

# Going with the free flow

Nov 29th 2007
From The Economist print edition

JUST as Norman Mailer, John Updike and Philip Roth were at various times regarded as the greatest American novelist since the second world war, John Ashbery and Robert Lowell vied for the title of greatest American poet. Yet the two men could not be more different.

Lowell was a public figure who engaged with politics—in 1967 he marched shoulder-to-shoulder with Mailer in protest against the Vietnam war, as described in Mailer's novel “The Armies of the Night”. Lowell took on substantial themes and envisioned himself as a tragic, heroic figure, fighting against his own demons.

Mr Ashbery's verse, by contrast, is more beguilingly casual. In his hands, the making of a poem can feel like the tumbling of dice on a table top. Visible on the page is a delicately playful strewing of words, looking to engage with each other in a shyly puzzled fashion. And there is an element of Dada-like play in his unpredictability of address with its perpetual shifting of tones, as in:

> “The lobster shouted how it was long ago
> No pen mightier than this said the object
> As though to ward off a step...”

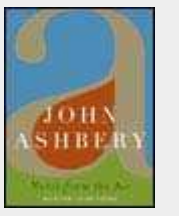
Lowell, who died in 1977 at the age of 60, addressed the world head on. By contrast, Mr Ashbery, who celebrated his 80th birthday earlier this year, glances wryly at the world and its absurdities. In this edition of his later poems, a substantial gathering of verses selected from six volumes published over the past 20 years, his poetry does not so much consist of themes to be explored as comic routines to be improvised. He mocks the very idea of the gravity of poetry itself. His tone can be alarmingly inconsequential, as if the reader is there to be perpetually wrong-footed. He shifts easily from the elevated to the work-a-day. His poems are endlessly digressive and there are often echoes of other poets in his writings, though these always come lightly at the reader, as though they were scents on the breeze.

Lowell wrote in strict formal measures; some of his last books consisted of entire sequences of sonnets. Mr Ashbery can also be partial to particular forms of verse, though these tend to be of a fairly eccentric kind—the cento (a patchwork of other poets' works), for example, and the pantoum (a Malaysian form, said to have been introduced to 19th-century Europe by Victor Hugo). Often he writes in a free-flowing, conversational manner that depends for its success upon the fact that the ending of lines is untrammelled by any concern about whether or not they scan. Within many of his poems, there often seems to be a gently humorous antagonism between one stanza and the next. Mr Ashbery likes using similes in his poetry. This is often the poet's stock-in-trade, but he seems to single them out in order to send up the very idea of the simile in poetry, as in “Violets blossomed loudly/ like a swear word in an empty tank”.

Life, for Lowell, was a serious matter, just as he was a serious man. Mr Ashbery's approach, as evinced by his poetry, is more that of a gentle shrug of amused bewilderment. Unlike Lowell's, his poems are neither autobiographical nor confessional. He doesn't take himself that seriously. “Is all of life a tepid housewarming?” For a poet this is a tougher question to answer than you might think.

Notes from the Air: Selected Later Poems.
By John Ashbery.
*Ecco; 384 pages; $34.95. Carcanet; £18.95*

Notes from the Air: Selected Later Poems
By John Ashbery




*Ecco; 384 pages; $34.95.*
*Carcanet; £18.95*

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Cleanliness

# Next to godliness

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From The Economist print edition

“I WILL return in five days. Stop washing,” Napoleon famously wrote to Joséphine de Beauharnais. Katherine Ashenburg offers many such details in her analysis of the changing attitudes to cleanliness in the West: the Greeks and Romans, who exercised naked and oiled and then scraped the dirt off; the early Christian saints who wore hair shirts to provide a cosy home for lice; aristocrats of the 16th and 17th centuries who were as dirty as commoners and thought that wearing linen would clean the body; the power showers and en-suite bathrooms of today.

Every culture, says Ms Ashenburg, defines for itself the perfect point between squalid and over-fastidious. And people like to believe that others get it wrong. The Spartans thought those who washed in hot water were on a slippery slope to sleeping late and losing their virility; the ancient Egyptians that the Greeks were foul for sitting in still water. Americans are repulsed by Europeans' crooked, cream-coloured teeth—and Europeans find phosphorescent, fake-looking American smiles equally off-putting.

Cleanliness symbolises purity. Like Pontius Pilate, we wash our hands of dirty deeds; Italy's anti-Mafia drive was called “clean hands”. Brides traditionally bathe the night before marrying; the dead are washed before being committed to the grave.

Judaism and Islam prescribe numerous purification rituals. Christianity is notably different. Jesus shocked the Pharisees by breaking bread without washing his hands—and set Christendom on a path of intermittent filthiness. After the Black Death closed Europe's bath houses, there was no bulwark of religious practice to hold back the tide of dirtiness. Elizabeth I bathed once a month, “whether I need it or not”. Her successor, James I, reportedly washed only his fingers. A general belief took hold that washing would open the pores and allow disease to enter.

Water's comeback in the late 18th century had as much to do with health as had its disappearance. The sick would try anything, even cold baths and dips in the sea. Sanitation was taken up by social reformers such as Charles Kingsley, whose book, “The Water Babies”, tells of a chimney sweep who was saved by applying a strict combination of cold water and prayer.

In the 19th century Americans took the lead on cleanliness. Washing was fresh, and Americans liked innovation in general and new sanitary gadgets in particular. It was meritocratic, improving the appearance of those from modest backgrounds. It was patriotic: immigrants were Americanised by being taught to wash. Ms Ashenburg's tale ends with the strange practices of Westerners who douche, depilate and deodorise; who smell like pomegranate, peppermint or even pine needles—but never, ever, like living people.

The Dirt on Clean: An Unsanitized History.
By Katherine Ashenburg.
*North Point Press; 368 pages; $24*

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By Katherine Ashenburg

*North Point Press; 368 pages; $24*

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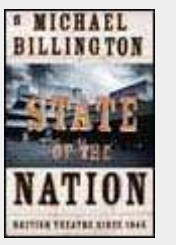
The British on the stage

# At the party of opposition

Nov 29th 2007
From The Economist print edition

MICHAEL BILLINGTON, the *Guardian* newspaper's chief theatre critic, says he has spent more than 8,000 nights at the theatre. This exhausting qualification enables him to take a long view of British theatre since 1945, and, on the whole, he gives it an excellent review. He recalls most vividly a memorable golden age in the late 1960s when he argues that the scope of British writing for the theatre was unequalled since that of William Shakespeare and his colleagues in the first Elizabethan age.

State of the Nation: British Theatre since 1945
By Michael Billington




*Faber and Faber; 435 pages; £25*

Buy it at Amazon.co.uk

This is not absurd. The list was extraordinary: Harold Pinter, John Osborne, Peter Nichols, Sir Tom Stoppard and Sir Alan Ayckbourn. With Alan Bennett, Caryl Churchill, Mike Leigh and Sir David Hare waiting in the wings, and Samuel Beckett sending an occasional contribution over from Paris. Moreover, Mr Billington declares that the British theatre had acquired a decisive new role—"a more or less permanent opposition to whichever party was in power". Since he is an admirer of the state-of-the-nation play, he approves of this development, and his principal criticism of the post-war era is that the theatre has sometimes failed in its duty to define exactly what is rotten in the state of Britain.

This can make him a killjoy. For instance, he deplores the Royal Shakespeare Company's eight-and-a-half-hour version of "Nicholas Nickleby", which many found absorbing. He regards it as a substitute for an investigation into contemporary society, which is what the company ought to have been doing. He liked Mark Ravenhill's "Shopping and Fucking", but not unreservedly: "I was left hungering for some concrete notion of a better society," he writes.

Mr Billington is a politically correct, cricket-loving lefty. Yet he has managed to produce a compelling narrative history of 60 years of British theatre which is a pleasure to read if for no other reason than the richly rewarding memories it revives. Take a few at random: Sir Laurence Olivier in "The Entertainer", Dame Joan Plowright as Beatie Bryant in Arnold Wesker's "Roots", Mr Pinter's "Betrayal", Sir Alan Ayckbourn's "Absurd Person Singular" (revived in London this week), and wondrous Shakespeare plays: Sir Peter Hall's "Wars of the Roses", Sir Peter Brook's "King Lear" with Paul Scofield, and Sir Trevor Nunn's "Macbeth", which starred Sir Ian McKellen and the formidable Dame Judi Dench.

The period began with confident forecasts of the death of the live theatre, which turned out to have been exaggerated. Mr Billington describes as "enormous" the impact of the Berliner Ensemble's London season in 1956, but notes that the British were influenced more by theatrical style than ideological content. Osborne's violent language reflected the disintegration of automatic deference, but Mr Billington does not credit "Look Back in Anger" with marking the vital turning point in post-war theatre, as most other critics have done.

His startling proposition is that the real turning point was the first night of "Beyond the Fringe" in 1960 because it helped to change attitudes to authority forever: "A talent to amuse was replaced by a talent to abuse." Mr Billington's enthusiasm withers in the 1970s: a time of disappointment, disillusion and a pervasive sense of despair. Nonetheless, he says, the theatre was still able accurately to reflect the shifts and changes in British society.

He is more distressed by the 1980s. By 1985, Mr Billington writes, 44% of all seats sold by West End theatres were bought by tourists who preferred expensively produced musicals. These, for him, exemplified the pursuit of profit—"Thatcherism's guiding principle". He jeers at Lady Thatcher for informing Sir Peter Hall, then director of the National Theatre, that British theatre was famous the world over: "Look at Andrew Lloyd Webber," she said.

Mr Billington believes that Sir Peter is the single most influential figure in the post-war British theatre and that his consistent support for new plays was especially important. This speaks well of his critical objectivity, for Sir Peter is not politically correct, cannot be bothered with cricket and is certainly not left-wing. And it is gratifying to read the conclusion—that Britain cannot be entirely rotten when the government subsidises a theatre that is instinctively opposed to its foreign policy.

State of the Nation: British Theatre since 1945.
By Michael Billington.
*Faber and Faber; 435 pages; £25*

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New cinema

# The story of an eye

Nov 29th 2007 | LOS ANGELES
From The Economist print edition

**“The Diving Bell and the Butterfly” makes a terrific film**

IT IS no wonder that Julian Schnabel wanted to direct “The Diving Bell and the Butterfly”, due to open in America on November 30th and adapted from a French book that became an international bestseller in 1997. By blinking his left eye, the author, Jean-Dominique Bauby, dictated a poetic account of his life after a paralysing stroke left him a prisoner of his own body. Mr Schnabel is one of America's leading painters, and Ronald Harwood's canny adaptation about a man who discovers his inner artist when he is reduced to a single eye offers the director limitless opportunities for visual experiments.

Outnow

**Life, one letter at a time**

Crucially, though, he never loses the human qualities of the story. Mathieu Amalric achieves a feat comparable to Bauby's by acting with one staring eye as his only means of expression. In a wrenching scene where Bauby cannot comfort his father (Max von Sydow), who is howling with grief into a speaker-phone, his eye gyrates like a trapped animal trying to escape—a visceral image of the character's unimaginable imprisonment.

Bauby, who died two days after his book was published, was French, and his ironic humour never deserted him. This is especially visible in the film's opening scenes, where Mr Schnabel forces the viewer into siding with the main character as he responds with incredulous growls to the people who are trying to cheer him up. Bauby is shocked into visualising himself from the outside for the first time when an unthinking friend tells him that the gang at the Café Flore in Paris thinks he is a vegetable. (“What kind of vegetable?” he wonders. “Carrots? Onions?”).

His musing initiates his escape from the deep-sea diving suit that his body has become. Flitting through Bauby's sensuous visions like a signature is the tiny image of a butterfly, the ancient symbol of the soul escaping its earthly cocoon through the power of consciousness. When those images finally give birth to his memoir, Bauby's imagination has transcended the grotesque tragedy of his situation—another old idea conveyed with rare directness in this strange and wonderful film.

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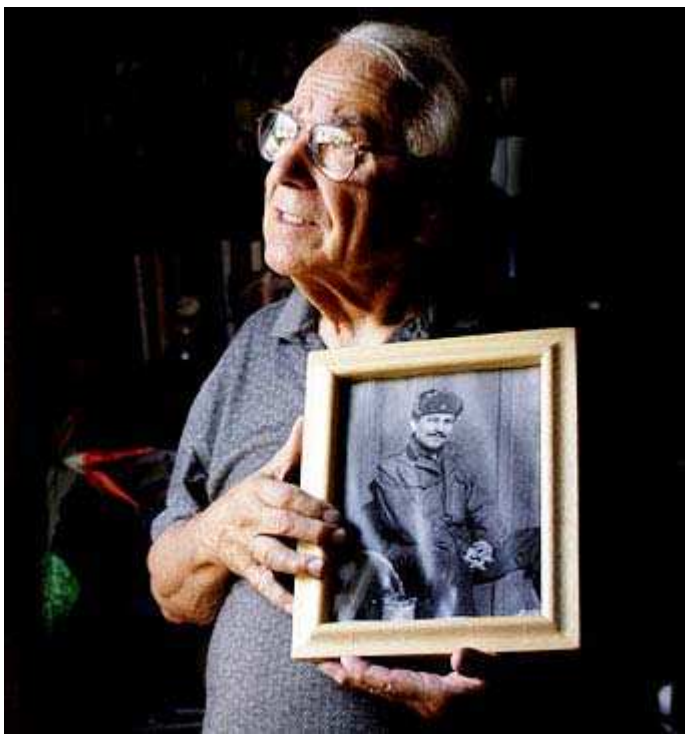
# Milo Radulovich

Nov 29th 2007
From The Economist print edition

**Milo Radulovich, avenging victim of the red scare, died on November 19th, aged 81**

AP



IF A single date marked the beginning of the end for the red scare whipped up by Senator Joseph McCarthy in post-war America, it was October 20th 1953. That was the day a whole television programme called “See It Now” was devoted to “The Case Against Lieut Milo Radulovich A0589839”.

Mr Radulovich was in most ways unexceptional. The son of an immigrant carworker in Detroit, he had become an air cadet at the age of 17 and then a member of the army air forces, in which he trained as a meteorologist. In 1952, after eight years' service, he was discharged, but remained in the air-force reserve. He got married, had two children, took two jobs and enrolled at the University of Michigan. A year later, though, he was handed a letter telling him he was being expelled from the air force. His “close and continuing association with his father and his sister”, he learned, had made him a security risk.

Mr Radulovich was not himself accused of being a communist, but his father was another matter. A Montenegrin Serb by birth, he liked to follow events in the land of his birth, and one of the Serbo-Croat newspapers to which he subscribed reflected the heterodox communism of Yugoslavia, the southern Slav union into which Serbia and Montenegro had been swept up. Mr Radulovich's sister was even more suspect. She was a leftist, and had been photographed picketing a Detroit hotel that had denied entry to Paul Robeson, a black singer and actor of international renown, who campaigned for civil rights and was openly sympathetic to communism. Thus was Mr Radulovich damned.

Not by everyone, it should be said. Determined to fight his corner but unable at first to find a lawyer prepared to take his case, he eventually found one who persuaded him to tell his tale to the *Detroit News*. A front-page story prompted a second lawyer to come forward—both gave their services free—and another *Detroit News* article caught the attention of Edward Murrow, the host of “See It Now”, a CBS news and documentary programme broadcast to the nation from New York.

## Fanfare for the common man

Murrow and his producer, Fred Friendly, had been wanting to make a programme about the red scare's witch-hunts for some time. Friendly quickly realised that in Mr Radulovich's story they had the perfect “little picture” to illustrate the big picture of McCarthyism, which, they believed, threatened not just academics, Hollywood entertainers and New York intellectuals but all Americans, even an unpretentious Midwesterner like Mr Radulovich.

CBS was less enthusiastic. Its bosses did not want to antagonise Alcoa, the company that both sponsored “See It Now” and sold quantities of aluminium to the air force. The programme was eventually broadcast, but Murrow and Friendly had themselves to pay the $1,500 needed for an advertisement in the *New York Times*: their employers were in a funk.

The viewers' response, though, exceeded all expectations. Letters poured in by the thousand and almost all were indignant at the treatment of Mr Radulovich. A month later he was cleared of all charges and reinstated by the air force. Three months after that, Murrow and Friendly tackled the big picture in a “See It Now” devoted to McCarthy himself. That programme, widely said to have opened America's eyes to the senator's dishonesty and bullying, could not have been made, said Friendly, but for the success of the earlier programme. By April 1954 McCarthy was being investigated in Senate hearings and by December he had been censured by the full Senate. He went into decline, drank ever more heavily and died in 1957.

Though exonerated, Mr Radulovich still found his life affected by the episode. His father soon died, his marriage broke up, he never got his degree and he was shunned by employers. But eventually he secured a job as a meteorologist in California. Years later, in 2005, he was hired to advise the makers of “Good Night, and Good Luck”, the movie about Murrow's efforts to expose McCarthyism in the face of charges that he was a communist.

Thereafter Mr Radulovich found himself in demand as a speaker on civil liberties. Though McCarthy's campaign was long dead, a new enemy, terrorism, was stalking the public imagination, and terms like racial profiling and sneak-and-peek searches had entered the language to describe practices that the red-scare demagogue might well have approved of.

The 2001 Patriot Act had given government agencies the right to examine citizens' library and bookshop records, bringing back memories of old Radulovich's supposedly incriminating reading habits. And President George Bush's plans to try “enemy combatants” in military tribunals, with their lower standards than civilian courts, were bringing back memories of the air-force hearing that had condemned the young Mr Radulovich. In that proceeding the air force's lawyer had brandished a sealed envelope supposedly containing evidence, though its contents were never to be seen by the accused or his defenders.

Mr Radulovich's great meteorological interest was the interaction of wind and fire—a fitting concern for one who could never escape the scorching he had suffered in an era of super-heated scare-mongering.

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# Overview

Nov 29th 2007
From The Economist print edition

The malaise in America's **housing market** deepened. The S&P/Case-Shiller index of national home prices declined by 1.7% in the third quarter, the biggest quarterly drop since the series began in 1986. Prices were 4.5% lower than in the third quarter of 2006. Sales of existing homes fell by 1.2% in October, 20.7% below their level a year earlier.

Consumer confidence in **America** dived to its lowest point since the aftermath of Hurricane Katrina in 2005. The Conference Board's index fell from 95.2 to 87.3 in November, the fourth straight monthly drop.

**Poland**'s central bank raised its key interest rate from 4.75% to 5%. The central banks of **Hungary**, **Israel** and **Malaysia** left their benchmark interest rates unchanged.

Business confidence in **Germany** improved a little in November, according to Ifo, a Munich-based research institute. Its business-climate index rose from 103.9 to 104.2. Industrialists in **France** were more upbeat too. The INSEE confidence index perked up to 110 from a five-month low of 108. But in **Italy** the ISAE Institute's gauge of business confidence fell further, to 92.2, its lowest reading in nearly two years.

Fears that **euro area inflation** will rise to 3% were stoked by a preliminary estimate for Germany, which showed its harmonised rate picking up from 2.7% to 3.3% in November.

**Britain's** GDP rose by 0.7% in the third quarter, revised from an initial estimate of 0.8%, leaving it 3.2% higher than a year earlier.

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# Output, prices and jobs

Nov 29th 2007
From The Economist print edition

## Output, prices and jobs

% change on year ago

| | Gross domestic product | | | | Industrial production | Consumer prices | | | Unemployment |
|---|---|---|---|---|---|---|---|---|---|
| | latest | qtr* | 2007† | 2008† | latest | latest | year ago | 2007† | rate‡, % |
| United States | +2.6 Q3 | +3.9 | +2.0 | +2.1 | +1.8 Oct | +3.5 Oct | +1.3 | +2.8 | 4.7 Oct |
| Japan | +2.1 Q3 | +2.6 | +2.0 | +1.8 | +0.8 Sep | –0.2 Sep | +0.6 | nil | 4.0 Sep |
| China | +11.5 Q3 | na | +11.5 | +10.0 | +17.9 Oct | +6.5 Oct | +1.4 | +4.5 | 9.5 2006 |
| Britain | +3.2 Q3 | +3.0 | +3.0 | +2.1 | –0.3 Sep | +2.1 Oct§ | +2.4 | +2.2 | 5.4 Sep†† |
| Canada | +2.5 Q2 | +3.6 | +2.6 | +2.3 | +0.2 Aug | +2.4 Oct | +1.0 | +2.2 | 5.8 Oct |
| Euro area | +2.6 Q3 | +2.8 | +2.6 | +2.0 | +3.5 Sep | +2.6 Oct | +1.6 | +2.0 | 7.3 Sep |
| Austria | +3.4 Q3 | +3.0 | +3.2 | +2.6 | +1.3 Sep | +2.8 Oct | +1.2 | +1.9 | 4.2 Oct |
| Belgium | +2.5 Q3 | +1.6 | +2.6 | +2.0 | nil Sep | +2.2 Oct | +1.2 | +1.7 | 11.1 Oct‡‡ |
| France | +2.1 Q3 | +2.9 | +1.8 | +1.9 | +1.6 Sep | +2.0 Oct | +1.1 | +1.4 | 8.1 Q2§§ |
| Germany | +2.5 Q3 | +2.8 | +2.6 | +2.1 | +6.1 Sep | +3.0 Nov | +1.5 | +2.1 | 8.6 Nov |
| Greece | +3.6 Q3 | na | +3.8 | +2.9 | +1.7 Sep | +3.1 Oct | +2.8 | +2.8 | 7.6 Aug |
| Italy | +1.9 Q3 | +1.5 | +1.7 | +1.4 | +0.3 Sep | +2.1 Oct | +1.8 | +1.9 | 6.0 Q2 |
| Netherlands | +4.1 Q3 | +7.2 | +2.5 | +2.2 | +2.3 Sep | +1.6 Oct | +1.1 | +1.7 | 4.3 Oct†† |
| Spain | +3.8 Q3 | +2.8 | +3.7 | +2.7 | +0.6 Sep | +3.6 Oct | +2.5 | +2.6 | 8.1 Oct |
| Czech Republic | +6.0 Q2 | +5.7 | +5.7 | +4.5 | +1.2 Sep | +4.0 Oct | +1.3 | +2.6 | 5.8 Oct |
| Denmark | +1.8 Q3 | +5.3 | +1.6 | +1.7 | –0.6 Sep | +1.7 Oct | +1.5 | +1.6 | 3.0 Oct |
| Hungary | +1.0 Q3 | +1.2 | +2.1 | +3.0 | +8.7 Sep | +6.7 Oct | +6.3 | +7.8 | 7.3 Oct†† |
| Norway | +3.1 Q3 | +5.6 | +3.3 | +2.6 | +0.3 Sep | –0.2 Oct | +2.7 | +0.4 | 2.6 Sep†† |
| Poland | +6.4 Q2 | na | +6.5 | +5.2 | +10.6 Oct | +3.0 Oct | +1.2 | +2.2 | 11.3 Oct‡‡ |
| Russia | +7.8 Q2 | na | +7.2 | +6.4 | +6.1 Oct | +9.5 Sep | +9.5 | +8.6 | 5.8 Oct‡‡ |
| Sweden | +2.5 Q3 | +2.4 | +3.4 | +3.0 | +1.1 Sep | +2.7 Oct | +1.3 | +1.8 | 5.7 Oct‡‡ |
| Switzerland | +2.8 Q2 | +3.0 | +2.6 | +2.0 | +9.8 Q2 | +1.2 Oct | +0.3 | +0.6 | 2.6 Oct‡‡ |
| Turkey | +3.9 Q2 | na | +5.2 | +5.1 | +2.2 Sep | +7.0 Oct | +10.0 | +8.5 | 9.2 Q3‡‡ |
| Australia | +4.3 Q2 | +3.8 | +4.2 | +3.7 | +4.6 Q2 | +1.9 Q3 | +3.9 | +2.4 | 4.3 Oct |
| Hong Kong | +6.2 Q3 | +7.0 | +6.1 | +4.5 | –2.3 Q2 | +3.2 Oct | +2.0 | +2.0 | 3.9 Oct†† |
| India | +9.3 Q2 | na | +8.0 | +7.9 | +6.4 Sep | +6.4 Sep | +6.8 | +6.2 | 7.6 2006 |
| Indonesia | +6.5 Q3 | na | +6.2 | +6.1 | –1.4 Sep | +6.9 Oct | +6.3 | +6.3 | 9.8 Feb |
| Malaysia | +6.7 Q3 | na | +6.0 | +5.8 | +3.4 Sep | +1.9 Oct | +3.1 | +2.0 | 3.4 Q2 |
| Pakistan | +7.0 2007** | na | +6.4 | +5.9 | +9.3 Aug | +9.3 Oct | +8.1 | +6.9 | 6.2 2006†† |
| Singapore | +9.4 Q3 | +6.4 | +7.4 | +4.8 | +0.9 Oct | +3.6 Oct | +0.4 | +1.8 | 1.7 Q3 |
| South Korea | +5.2 Q3 | +1.4 | +5.0 | +4.7 | +17.8 Oct | +3.0 Oct | +2.2 | +2.5 | 3.1 Oct |
| Taiwan | +6.9 Q3 | na | +4.3 | +4.4 | +15.9 Oct | +5.3 Oct | –1.2 | +1.4 | 3.9 Oct |
| Thailand | +4.4 Q2 | +5.2 | +4.5 | +4.9 | +9.2 Sep | +2.5 Oct | +2.8 | +2.0 | 1.2 Aug |
| Argentina | +8.7 Q2 | +8.8 | +8.3 | +6.0 | +1.5 Sep | +8.4 Oct | +10.5 | +8.8 | 8.1 Q3‡‡ |
| Brazil | +5.4 Q2 | +3.2 | +4.7 | +4.5 | +5.6 Sep | +4.1 Oct | +3.3 | +3.6 | 9.0 Sep†† |
| Chile | +4.1 Q3 | –2.5 | +5.6 | +5.5 | +1.3 Sep | +6.5 Oct | +2.1 | +4.1 | 7.7 Sep†††† |
| Colombia | +6.9 Q2 | +4.4 | +6.7 | +5.6 | +6.0 Sep | +5.2 Oct | +4.2 | +5.5 | 10.6 Sep†† |
| Mexico | +3.3 Q3 | +5.9 | +3.0 | +2.9 | +0.4 Sep | +3.7 Oct | +4.3 | +4.0 | 3.9 Oct‡‡ |
| Venezuela | +8.7 Q3 | na | +6.9 | +4.8 | +9.3 Aug | +17.2 Oct | +15.5 | +17.8 | 8.5 Q3‡‡ |
| Egypt | +6.9 Q3 | nil | +7.1 | +7.3 | +7.5 2007** | +7.5 Oct | +11.8 | +9.2 | 8.1 Q2‡‡ |
| Israel | +4.8 Q3 | +6.1 | +5.3 | +4.2 | –3.3 Sep | +2.2 Oct | –0.2 | +0.4 | 7.3 Q3 |
| Saudi Arabia | +4.3 2006 | na | +4.7 | +5.6 | na | +4.9 Sep | +2.5 | +4.0 | na |
| South Africa | +5.1 Q3 | +4.7 | +4.9 | +5.1 | –1.4 Sep | +7.9 Oct | +5.4 | +6.2 | 25.5 Mar‡‡ |
| **MORE COUNTRIES** Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | |
| Estonia | +6.4 Q3 | +7.4 | +7.9 | +5.3 | +5.8 Sep | +8.5 Oct | +3.7 | +6.1 | 5.7 Sep |
| Finland | +4.7 Q2 | +3.8 | +4.1 | +3.2 | +1.1 Sep | +2.7 Oct | +1.8 | +2.6 | 7.0 Oct |
| Iceland | +2.5 Q2 | +9.1 | +1.8 | +3.2 | +7.6 2006 | +5.2 Nov | +7.3 | +5.0 | 0.8 Oct‡‡ |
| Ireland | +5.4 Q2 | –5.5 | +4.6 | +3.5 | +4.3 Sep | +4.8 Oct | +3.9 | +4.7 | 4.8 Oct |
| Latvia | +11.1 Q3 | na | +10.7 | +7.5 | nil Sep | +13.2 Oct | +5.6 | +10.1 | 5.2 Sep |
| Lithuania | +10.8 Q3 | +10.0 | +7.8 | +6.9 | na | +7.6 Oct | +3.6 | +5.4 | 4.2 Oct |
| Luxembourg | +5.3 Q2 | +5.3 | +5.0 | +4.4 | –2.0 Aug | +2.9 Oct | +1.5 | +2.3 | 4.2 Sep‡‡ |
| New Zealand | +3.8 Q2 | +3.4 | +3.1 | +2.8 | +0.5 Q2 | +1.8 Q3 | +3.5 | +2.5 | 3.5 Q3 |
| Peru | +8.8 Sep | na | +7.5 | +6.5 | +9.4 Sep | +3.1 Oct | +1.9 | +1.7 | 8.4 Sep†† |
| Philippines | +6.6 Q3 | +1.1 | +6.9 | +5.0 | –1.0 Sep | +2.7 Oct | +5.4 | +2.7 | 7.8 Q3‡‡ |
| Portugal | +1.8 Q3 | nil | +1.8 | +2.0 | +1.4 Sep | +2.6 Oct | +2.7 | +2.3 | 7.9 Q3‡‡ |
| Slovakia | +9.4 Q3 | na | +8.5 | +6.5 | +15.4 Sep | +3.3 Oct | +3.7 | +2.7 | 8.3 Sep |
| Slovenia | +5.9 Q2 | na | +5.6 | +4.6 | +2.9 Sep | +5.1 Oct | +1.5 | +3.2 | 7.2 Sep‡‡ |

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions. §RPI inflation rate 4.2% in Oct. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. §§New series.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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# *The Economist* commodity-price index

Nov 29th 2007
From The Economist print edition

## *The Economist* commodity-price index

2000=100

| | Nov 20th | Nov 27th* | % change on one month | % change on one year |
|---|---|---|---|---|
| **Dollar index** | | | | |
| All items | 210.3 | 212.2 | –1.3 | +14.4 |
| Food | 197.8 | 201.8 | +3.8 | +30.8 |
| Industrials | | | | |
| All | 226.5 | 225.6 | –6.5 | –0.2 |
| Nfa† | 175.1 | 176.1 | +1.2 | +30.5 |
| Metals | 254.6 | 252.6 | –9.1 | –8.3 |
| **Sterling index** | | | | |
| All items | 154.5 | 155.4 | –1.4 | +7.6 |
| **Euro index** | | | | |
| All items | 131.6 | 132.0 | –4.2 | +1.2 |
| **Gold** | | | | |
| $ per oz | 793.25 | 812.75 | +3.6 | +27.8 |
| **West Texas Intermediate** | | | | |
| $ per barrel | 99.07 | 94.42 | +4.9 | +55.2 |

*Provisional †Non-food agriculturals.

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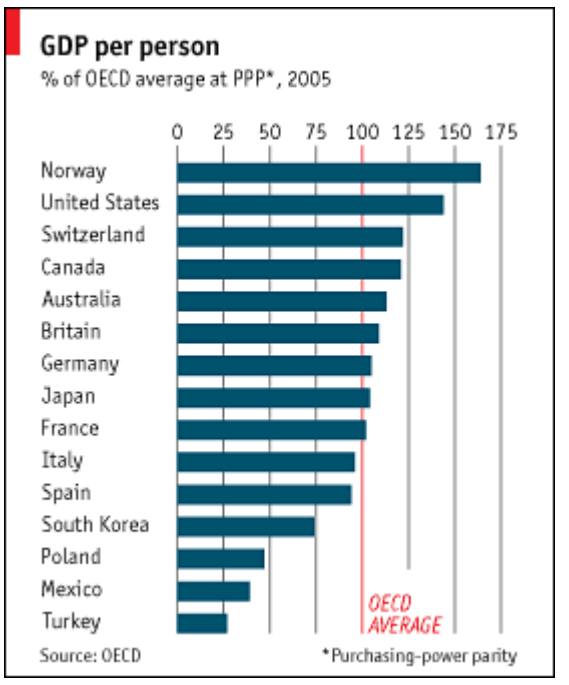
# GDP per person

Nov 29th 2007
From The Economist print edition




With the exception of tiny Luxembourg, Norway has the highest GDP per head of the 30 mainly rich countries in the OECD, according to new calculations from the Paris-based organisation. Higher oil revenues raised Norway's GDP per head to 164% of the OECD average by 2005, an increase of 19 percentage points from 2002. Comparisons are based on purchasing-power parity, which takes account of price differences between countries. On that basis, living standards in Britain, Germany, Japan, France and Italy are all close to the OECD average. America's income per head is comfortably above that level. Poland, Mexico and Turkey are the club's poorest members, with incomes per head of less than half the average.

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# Trade, exchange rates, budget balances and interest rates

Nov 29th 2007
From The Economist print edition

## Trade, exchange rates, budget balances and interest rates

| | Trade balance* latest 12 months, $bn | Current-account balance latest 12 months, $bn | Current-account balance % of GDP 2007† | Currency units, per $ Nov 28th | Currency units, per $ year ago | Budget balance % of GDP 2007† | Interest rates, % 3-month latest | Interest rates, % 10-year gov't bonds, latest |
|---|---|---|---|---|---|---|---|---|
| United States | −805.0 Sep | −793.2 Q2 | −5.5 | – | – | −1.2 | 4.34 | 4.03 |
| Japan | +104.0 Sep | +205.0 Sep | +4.7 | 110 | 116 | −2.6 | 0.73 | 1.49 |
| China | +256.5 Oct | +249.9 2006 | +10.9 | 7.39 | 7.83 | 0.2 | 4.36 | 4.82 |
| Britain | −164.4 Sep | −86.6 Q2 | −3.3 | 0.48 | 0.51 | −3.0 | 6.51 | 4.70 |
| Canada | +48.4 Sep | +21.9 Q2 | +1.7 | 0.99 | 1.14 | 1.0 | 3.89 | 4.06 |
| Euro area | +44.5 Sep | +27.9 Aug | +0.1 | 0.68 | 0.76 | −0.9 | 4.74 | 4.11 |
| Austria | +1.5 Aug | +12.3 Q2 | +2.9 | 0.68 | 0.76 | −0.6 | 4.74 | 4.15 |
| Belgium | +18.9 Sep | +13.0 Jun | +2.4 | 0.68 | 0.76 | −0.1 | 4.81 | 4.31 |
| France | −44.4 Sep | −28.0 Sep | −1.1 | 0.68 | 0.76 | −2.4 | 4.74 | 4.24 |
| Germany | +239.3 Sep | +204.5 Sep | +5.6 | 0.68 | 0.76 | −0.4 | 4.74 | 4.10 |
| Greece | −51.1 Aug | −41.7 Sep | −13.1 | 0.68 | 0.76 | −2.7 | 4.74 | 4.45 |
| Italy | −13.6 Sep | −47.7 Sep | −2.5 | 0.68 | 0.76 | −2.4 | 4.74 | 4.46 |
| Netherlands | +51.1 Sep | +57.2 Q3 | +7.8 | 0.68 | 0.76 | −0.3 | 4.74 | 4.22 |
| Spain | −126.0 Sep | −125.1 Jul | −9.1 | 0.68 | 0.76 | 1.8 | 4.74 | 4.31 |
| Czech Republic | +3.5 Sep | −5.8 Sep | −3.5 | 18.0 | 21.3 | −3.9 | 3.84 | 4.58 |
| Denmark | +3.9 Sep | +4.0 Sep | +1.9 | 5.05 | 5.67 | 3.8 | 4.90 | 4.21 |
| Hungary | −1.4 Sep | −6.8 Q2 | −5.8 | 172 | 196 | −6.0 | 7.48 | 6.80 |
| Norway | +54.7 Oct | +54.6 Q2 | +14.3 | 5.48 | 6.26 | 18.9 | 5.72 | 4.68 |
| Poland | −11.3 Sep | −15.5 Sep | −4.3 | 2.47 | 2.90 | −2.0 | 5.50 | 5.73 |
| Russia | +121.5 Sep | +73.5 Q3 | +5.6 | 24.4 | 26.3 | 4.0 | 10.00 | 6.36 |
| Sweden | +18.5 Oct | +29.4 Q3 | +7.1 | 6.33 | 6.91 | 2.8 | 3.90 | 4.20 |
| Switzerland | +11.3 Oct | +64.9 Q2 | +16.3 | 1.12 | 1.21 | 0.3 | 2.75 | 2.87 |
| Turkey | −56.9 Sep | −34.4 Sep | −7.3 | 1.19 | 1.47 | −2.8 | 17.21 | 6.43‡ |
| Australia | −13.6 Sep | −47.1 Q2 | −5.7 | 1.13 | 1.27 | 1.6 | 7.21 | 5.89 |
| Hong Kong | −21.1 Sep | +24.9 Q2 | +9.7 | 7.79 | 7.78 | 1.9 | 3.84 | 3.15 |
| India | −65.4 Sep | −9.7 Q2 | −1.2 | 39.8 | 44.7 | −3.3 | 7.50 | 8.24 |
| Indonesia | +41.3 Sep | +11.0 Q2 | +2.5 | 9,418 | 9,168 | −1.7 | 8.07 | 6.72‡ |
| Malaysia | +29.1 Sep | +27.6 Q2 | +13.5 | 3.38 | 3.63 | −3.2 | 3.62 | 4.37‡ |
| Pakistan | −15.0 Oct | −7.1 Q2 | −4.6 | 61.1 | 60.8 | −4.6 | 9.79 | 9.16‡ |
| Singapore | +37.4 Oct | +46.3 Q3 | +27.4 | 1.44 | 1.54 | 0.3 | 2.58 | 2.82 |
| South Korea | +19.1 Oct | +9.1 Sep | +1.0 | 932 | 931 | 0.4 | 5.40 | 5.87 |
| Taiwan | +15.7 Oct | +28.4 Q3 | +6.3 | 32.3 | 32.5 | −2.0 | 2.60 | 2.70 |
| Thailand | +9.7 Sep | +11.8 Sep | +3.6 | 33.8 | 36.0 | −1.9 | 3.60 | 4.76 |
| Argentina | +10.7 Oct | +7.4 Q2 | +2.7 | 3.15 | 3.08 | 1.4 | 14.19 | na |
| Brazil | +42.6 Oct | +7.4 Oct | +0.7 | 1.80 | 2.18 | −1.8 | 11.18 | 6.16‡ |
| Chile | +24.7 Oct | +8.3 Q2 | +4.8 | 511 | 530 | 8.1 | 5.88 | 4.71‡ |
| Colombia | −1.9 Aug | −4.8 Q2 | −3.8 | 2,066 | 2,301 | −0.2 | 8.56 | 5.98‡ |
| Mexico | −12.1 Oct | −7.0 Q2 | −0.6 | 10.9 | 11.0 | nil | 7.44 | 7.99 |
| Venezuela | +23.8 Q2 | +20.4 Q2 | +7.7 | 5,850§ | 3,438§ | −2.2 | 11.25 | 6.55‡ |
| Egypt | −15.8 Q2 | +2.7 Q2 | +1.8 | 5.53 | 5.72 | −7.5 | 7.12 | 5.36‡ |
| Israel | −9.5 Oct | +7.8 Q2 | +3.7 | 3.87 | 4.26 | −0.5 | 4.25 | 5.19 |
| Saudi Arabia | +146.6 2006 | +98.9 2006 | +23.2 | 3.72 | 3.75 | 18.9 | 4.28 | na |
| South Africa | −11.0 Sep | −17.4 Q2 | −6.8 | 6.89 | 7.13 | 0.5 | 11.00 | 8.43 |
| **MORE COUNTRIES** Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | |
| Estonia | −4.1 Sep | −3.1 Aug | −14.6 | 10.6 | 11.9 | 3.1 | 5.36 | na |
| Finland | +12.8 Sep | +13.2 Sep | +6.4 | 0.68 | 0.76 | 4.2 | 4.65 | 4.22 |
| Iceland | −1.8 Oct | −3.7 Q2 | −16.9 | 61.6 | 68.6 | 5.3 | 14.16 | na |
| Ireland | +36.9 Sep | −10.5 Q2 | −5.2 | 0.68 | 0.76 | 1.1 | 4.74 | 4.35 |
| Latvia | −7.2 Sep | −6.3 Aug | −22.2 | 0.47 | 0.53 | 0.4 | 10.10 | na |
| Lithuania | −6.6 Sep | −4.5 Sep | −14.5 | 2.34 | 2.63 | −0.5 | 6.64 | na |
| Luxembourg | −5.8 Aug | +4.6 Q2 | na | 0.68 | 0.76 | 0.3 | 4.74 | na |
| New Zealand | −4.2 Oct | −9.2 Q2 | −8.1 | 1.30 | 1.47 | 4.8 | 7.30 | 6.24 |
| Peru | +8.5 Sep | +2.8 Q2 | +1.1 | 3.00 | 3.22 | 0.7 | 5.00 | na |
| Philippines | −4.3 Sep | +6.4 Jun | +5.9 | 42.9 | 49.7 | −0.9 | 6.75 | na |
| Portugal | −23.8 Aug | −18.1 Aug | −8.5 | 0.68 | 0.76 | −3.0 | 4.74 | 4.38 |
| Slovakia | −1.1 Sep | −3.8 Jul | −4.4 | 22.6 | 27.0 | −2.9 | 4.12 | 4.63 |
| Slovenia | −2.6 Sep | −1.4 Aug | −3.2 | 0.68 | 0.76 | −0.5 | na | na |

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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# Markets

Nov 29th 2007
From The Economist print edition

## Markets

| | Index Nov 28th | % change on one week | % change on Dec 29th 2006 in local currency | % change on Dec 29th 2006 in $ terms |
|---|---|---|---|---|
| United States (DJIA) | 13,289.5 | +3.8 | +6.6 | +6.6 |
| United States (S&P 500) | 1,469.0 | +3.7 | +3.6 | +3.6 |
| United States (NAScomp) | 2,662.9 | +3.9 | +10.3 | +10.3 |
| Japan (Nikkei 225) | 15,153.8 | +2.1 | −12.0 | −4.7 |
| Japan (Topix) | 1,475.6 | +2.6 | −12.2 | −4.9 |
| China (SSEA) | 5,041.8 | −7.9 | +79.1 | +89.0 |
| China (SSEB, $ terms) | 319.5 | −7.6 | +132.6 | +145.5 |
| Britain (FTSE 100) | 6,306.2 | +3.9 | +1.4 | +7.3 |
| Canada (S&P TSX) | 13,632.2 | +2.6 | +5.6 | +23.9 |
| Euro area (FTSE Euro 100) | 1,355.1 | +3.1 | +6.0 | +18.6 |
| Euro area (DJ STOXX 50) | 4,321.7 | +3.0 | +4.9 | +17.4 |
| Austria (ATX) | 4,373.5 | +4.8 | −2.0 | +9.7 |
| Belgium (Bel 20) | 4,091.0 | +5.4 | −6.8 | +4.3 |
| France (CAC 40) | 5,561.2 | +3.3 | +0.4 | +12.3 |
| Germany (DAX)* | 7,723.7 | +2.7 | +17.1 | +31.0 |
| Greece (Athex Comp) | 4,951.7 | +2.8 | +12.7 | +26.1 |
| Italy (S&P/MIB) | 38,487.0 | +3.0 | −7.1 | +3.9 |
| Netherlands (AEX) | 500.2 | +3.4 | +1.0 | +13.0 |
| Spain (Madrid SE) | 1,684.8 | +1.3 | +8.4 | +21.3 |
| Czech Republic (PX) | 1,748.1 | +1.2 | +10.0 | +27.9 |
| Denmark (OMXCB) | 443.6 | +4.6 | +4.6 | +17.0 |
| Hungary (BUX) | 24,667.3 | −2.5 | −0.7 | +10.0 |
| Norway (OSEAX) | 564.9 | +3.4 | +12.4 | +27.8 |
| Poland (WIG) | 55,778.3 | +2.0 | +10.6 | +30.2 |
| Russia (RTS, $ terms) | 2,168.1 | +0.8 | +4.5 | +12.8 |
| Sweden (Aff.Gen) | 342.9 | +3.9 | −6.1 | +1.4 |
| Switzerland (SMI) | 8,650.8 | +6.5 | −1.5 | +7.6 |
| Turkey (ISE) | 53,202.8 | +1.1 | +36.0 | +61.8 |
| Australia (All Ord.) | 6,432.8 | −0.3 | +14.0 | +28.2 |
| Hong Kong (Hang Seng) | 27,371.2 | +2.8 | +37.1 | +37.0 |
| India (BSE) | 18,938.9 | +1.8 | +37.4 | +52.7 |
| Indonesia (JSX) | 2,671.9 | +4.2 | +48.0 | +41.3 |
| Malaysia (KLSE) | 1,366.6 | +0.5 | +24.7 | +30.0 |
| Pakistan (KSE) | 13,884.9 | +2.8 | +38.3 | +37.9 |
| Singapore (STI) | 3,369.7 | +0.7 | +12.9 | +19.9 |
| South Korea (KOSPI) | 1,834.7 | +1.5 | +27.9 | +27.7 |
| Taiwan (TWI) | 8,276.3 | −2.4 | +5.8 | +6.6 |
| Thailand (SET) | 820.5 | +1.6 | +20.7 | +28.9 |
| Argentina (MERV) | 2,230.8 | +0.7 | +6.7 | +4.0 |
| Brazil (BVSP) | 61,714.0 | +1.9 | +38.8 | +64.8 |
| Chile (IGPA) | 14,325.5 | +2.7 | +15.8 | +20.7 |
| Colombia (IGBC) | 11,212.2 | +0.5 | +0.5 | +8.9 |
| Mexico (IPC) | 29,276.4 | +2.9 | +10.7 | +9.6 |
| Venezuela (IBC) | 37,881.9 | +0.2 | −27.5 | −58.5 |
| Egypt (Hermes) | 85,211.4 | −1.3 | +39.0 | +43.6 |
| Israel (TA-100) | 1,129.5 | +1.8 | +22.5 | +33.6 |
| Saudi Arabia (Tadawul) | 9,464.4 | −0.6 | +19.3 | +20.4 |
| South Africa (JSE AS) | 29,410.1 | +0.9 | +18.0 | +20.8 |
| Europe (FTSEurofirst 300) | 1,501.3 | +4.0 | +1.2 | +13.2 |
| World, dev'd (MSCI) | 1,592.2 | +3.2 | +7.3 | +7.3 |
| Emerging markets (MSCI) | 1,203.7 | +1.3 | +31.9 | +31.9 |
| World, all (MSCI) | 402.5 | +3.0 | +9.4 | +9.4 |
| World bonds (Citigroup) | 737.3 | −0.9 | +12.0 | +12.0 |
| EMBI+ (JPMorgan) | 428.4 | +0.7 | +5.2 | +5.2 |
| Hedge funds (HFRX) | 1,320.4 | nil | +3.5 | +3.5 |
| Volatility, US (VIX) | 24.1 | 26.8 | 11.6 | (levels) |
| CDSs, Eur (iTRAXX)† | 59.2 | +1.5 | +153.9 | +184.2 |
| CDSs, N Am (CDX)† | 89.7 | −6.2 | +168.2 | +168.2 |
| Carbon trading (EU ETS) €‡ | 23.6 | −0.5 | +29.3 | +44.7 |

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡New series.

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# Benchmark interest rates

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From The Economist print edition

The Federal Reserve is widely expected to reduce its key interest rate by 25 basis points when it next meets on December 11th. America's central bank has already cut rates by 75 basis points since September. At the beginning of the Fed's previous rate-cutting cycle in 2001, its lead was swiftly followed by policymakers elsewhere. But this year no other rich-world central bank has yet lowered its key lending rate. In several countries—including Sweden, Norway and Australia—policy has been tightened since the Fed's first cut. Facing rising inflation, China has also made its money dearer. In the euro area and Britain policy rates were raised earlier in the year, but have been on hold since the summer.

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